Comptroller of the Currency
Administrator of National Banks

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Comptroller — Robert L. Clarke

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Background

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a 5-year term.

The OCC regulates national banks by its power to:

- Approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;
- Examine the banks;
- Take supervisory actions against banks that do not conform to laws and regulations or otherwise engage in unsound banking practices, including removal of officers, negotiation of agreements to change existing banking practices, and issuance of cease and desist orders; and
- [illegible]

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The Comptroller

Robert Logan Clarke became the 26th Comptroller of the Currency on December 16, 1985.

By statute, the Comptroller serves a concurrent term as a Director of the Federal Deposit Insurance Corporation and of the Resolution Trust Corporation, and as a member of the Federal Financial Institutions Examination Council.

As an attorney, Mr. Clarke was formerly with the law firm of Bracewell & Patterson in Houston, Texas. He joined the firm in 1968 and was named to Bracewell's partnership in 1972.

Mr. Clarke received a B.A. degree from Rice University in 1963 and an LL.B. degree from Harvard University Law School in 1966. He served as a Captain in the United States Army from 1966 to 1968.

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Quarterly Journal

Office of the Comptroller of the Currency

Robert L. Clarke

Comptroller of the Currency

The Administrator of National Banks

Contents

Operations of National Banks

Preliminary third quarter 1990 results for 4,006 reporting national banks indicate that national banks earned $1.56 billion for the three months ending September 30, a decline from the $2.62 billion earned in the second quarter and the $3.26 billion earned in the first quarter of 1990. The results represented the lowest third quarter earnings for national banks in the last six years.

Through September 30, 1990, national banks had earned $7.44 billion, which was $2.86 billion lower than earned in the first nine months of 1989 and $2.43 billion lower than earned in the first nine months of 1988. The average annualized return on assets (ROA) was 0.51 percent, down from 0.73 percent and 0.74 percent in the first nine months of 1989 and 1988 respectively.

Substantial new allocations to loan loss reserves contributed significantly to the drop in income in the third quarter, compared to the two previous quarters, and to smaller earnings in the first nine months of 1990, compared to both 1989 and 1988. Loan loss provisions were $5.27 billion during the quarter, an increase from $4.12 billion during each of the two preceding quarters of 1990. Since the beginning of the year, national banks have made loan loss provisions of $13.51 billion, up $3.03 billion compared to the first nine months of 1989 and up $5.95 billion compared to the first nine months of 1988.

The relatively high loan loss provisions in 1990 reflect increased loan losses and rising levels of noncurrent and restructured loans. National banks charged off $3.81 billion in loans in the three months ending September 30, 1990, bringing net loan losses for the year to $13.59 billion, up 128 percent compared to charge offs during the first nine months of 1989. Noncurrent loans — loans that are 90 or more days past due and nonaccrual loans — increased $3.57 billion in the third quarter to bring the increase in noncurrent loans since the beginning of the year to $6.25 billion. Restructured loans — loans that are current, but on modified terms — rose $740 million in the quarter, bringing their increase for the year to $2.25 billion.

Real estate loans displayed the most significant deterioration in the third quarter, as they have throughout 1990. Noncurrent real estate loans rose $2.48 billion in the third quarter, and have increased $6.00 billion since the end of 1989. In addition, other real estate owned (OREO) — essentially foreclosed real estate — rose $1.92 billion in the third quarter to bring the increase for the year to $3.41 billion for the year. Noncurrent and foreclosed real estate loans increased 15 percent in the quarter and were 38 percent higher than at the end of 1989.

The largest increases in noncurrent and foreclosed real estate loans since the end of 1989 have occurred in the national banks affiliated with seven large multinational bank holding companies and the national banks located in the OCC's Northeastern District. In the first nine months of 1990, noncurrent and foreclosed real estate loans rose $5.02 billion (up 76 percent) in the multinational banks and $4.83 billion (up 90 percent) in the Northeastern District. During those nine months, noncurrent and foreclosed real estate loans also rose, but by substantially smaller amounts, in the Southeastern, Central, Midwestern, and Western districts.

The Southwestern District was the only area in which noncurrent and foreclosed real estate declined in the first nine months of 1990, dropping $2.90 billion (down 44 percent). Unfortunately, this decline does not indicate a substantial improvement in the performance of real estate loans in that district. Rather, those trends stem largely from the transfer of problem assets from national banks to the FDIC, which occurred in connection with failed or troubled bank resolutions.

Even with the $2.90 billion drop in noncurrent and foreclosed real estate loans, problem real estate remains a significant burden on Southwestern District national banks. At 12 percent, the ratio of noncurrent real estate loans plus OREO to real estate loans plus OREO is higher in the Southwest than in other region of the country. The ratio is 10 percent in the Northeast, 8 percent in the multinational banks, and less than 4 percent in each of the other OCC districts

Asset growth slowed and even became negative throughout much of the country, partially as a result of rising asset quality concerns and a weakening economy. In the third quarter, aggregate national bank assets dropped by $940 million, falling in the Southeast, Southwest, and West, and in the multinational banks. Since the beginning of the year, aggregate national bank assets have increased by only $3.11 billion, an annual rate of growth of approximately 0.21 percent, and assets have fallen in both the Northeast and Southwest

Stephen M. Cross
Industry and Financial Analysis Division

Aggregate Performance Statistics for National Banks
(Data through September 30, 1990)

	9/30/85	9/30/86	9/30/87	9/30/88	9/30/89	9/30/90
Industry Structure						
Number of Banks	4,941	4,896	4,681	4,375	4,201	4,006
Number of Banks with Losses	868	1,071	978	731	592	551
Number of Failed Banks	23	36	49	68	86	86
Income Statement ($Billions)						
Year-To-Date						
Net Income	7.77	7.23	−1.33	9.87	10.30	7.44
Net Operating Cash Flow	14.64	15.58	16.85	16.89	20.16	20.69
Net Interest Income	39.52	41.82	43.48	45.96	49.96	50.19
Noninterest Income	14.46	16.66	18.14	20.31	23.60	25.40
Noninterest Expense	36.73	40.15	42.72	45.01	48.51	51.37
Loan Loss Provision	7.63	10.24	19.06	7.56	10.48	13.51
Net Loan Loss	5.54	7.27	6.74	9.04	8.63	13.59
Third Quarter						
Net Income	2.76	2.81	3.58	5.21	2.00	1.56
Net Operating Cash Flow	5.26	5.25	5.63	6.18	7.02	6.78
Net Interest Income	13.52	14.17	14.86	15.56	16.59	16.89
Noninterest Income	5.22	5.86	6.42	6.72	8.26	8.44
Noninterest Expense	12.49	13.72	14.45	14.59	16.36	17.45
Loan Loss Provision	2.69	3.21	2.21	1.05	5.24	5.27
Net Loan Loss	2.15	2.68	2.30	2.46	2.74	3.81
Performance Ratios (%)						
Year-To-Date						
Return on Equity	11.37	9.93	−1.77	12.89	12.39	8.57
Return on Assets	0.68	0.59	−0.10	0.74	0.73	0.51
Net Interest Income to Assets	3.45	3.44	3.39	3.44	3.55	3.43
Loss Provision to Assets	0.67	0.84	1.48	0.57	0.75	0.92
Noninterest Income to Assets	1.26	1.37	1.41	1.52	1.68	1.74
Noninterest Expense to Assets	3.21	3.30	3.33	3.37	3.45	3.51
Real Estate Loans to Loans	25.93	28.13	31.43	33.91	36.20	38.71
Noncurrent Loans to Loans	3.04	3.05	3.84	3.58	3.26	3.67
Noncurrent RE Loans to RE Loans	2.34	2.85	3.08	3.33	3.13	4.39
Loss Reserve to Loans	1.41	1.67	2.78	2.74	2.44	2.48
Loss Reserve to Noncurrent Loans	46.30	54.85	72.45	76.59	74.80	67.54
Net Loan Loss to Loans	0.77	0.96	0.84	1.06	0.94	1.43
Loss Provision to Net Loan Loss	137.85	140.85	282.88	83.57	121.46	99.46
Equity Capital to Assets	6.04	6.06	5.81	5.83	5.94	6.05
Primary Capital to Assets + Reserves	7.09	7.26	7.70	7.71	7.63	7.75

Industry and Financial Analysis

Aggregate Performance Statistics for National Banks
(Data through Third Quarter 1990)

	9/30/85	*9/30/86*	*9/30/87*	*9/30/88*	*9/30/89*	*9/30/90*
Balance Sheet ($Billions)						
Total Assets	1,563 12	1,664 42	1,725 55	1,817 29	1,921 11	1,979 07
Total Deposits	1,199 16	1,260 00	1,305 36	1,374 95	1 443 84	1 525 39
Total Liabilities	1,468 70	1,563 55	1,625 25	1,711 19	1,806 88	1,859 17
Volatile Liabilities	218 03	225 19	249 50	397 09	436 23	398 53
Total Loans	980 08	1,041 18	1,096 39	1,171 45	1,255 94	1,285 99
Real Estate Loans	254 14	292 89	344 63	397 29	454 64	497 79
Commercial & Industrial Loans	359 76	357 34	359 74	369 12	386 75	387 84
Loans to Individuals	186 13	205 06	208 30	226 74	242 53	237 70
Noncurrent Loans	29 76	31 73	42 11	41 94	41 00	47 24
Noncurrent Real Estate Loans	5 94	8 36	10 63	13 22	14 21	21 87
Other Real Estate Owned	3 87	4 82	6 00	8 12	7 99	12 62
Restructured Loans	n/a	1 21	1 54	1 43	1 38	3 60
Loan Loss Reserve	13 78	17.40	30 51	32 12	30 67	31 91
Equity Capital	94 35	100 80	100 23	106 02	114 15	119 83
Primary Capital	111 84	122 09	135 13	142 63	149 01	155 89
Balance Sheet Changes ($Billions)						
Year-To-Date Gains (Losses)						
Assets	65 95	34 49	(14 93)	47 37	74 93	3 11
Loans	45 14	33 31	13 88	49 93	61 82	6 04
Real Estate Loans	22 63	29 17	36 31	39 74	47 02	31 57
Loan Loss Reserve	2 13	2.97	12 42	(0 08)	0 84	(0 45)
Noncurrent Loans	1.51	3 95	11 29	(0 11)	4 94	6 25
Noncurrent Real Estate Loans	1 08	2 18	2 12	2 00	3 60	6 00
Other Real Estate Owned	0 54	0.91	1 03	1 93	1 25	3 41
Restructured Loans	n/a	n/a	0 27	0 03	(0 15)	2 25
Equity Capital	6 41	4 67	(2 00)	6.24	6.00	6 20
Primary Capital	9 53	7 70	10 80	6 19	6 73	5 70
Third Quarter Gains (Losses)						
Assets	36 89	17 55	13 53	20 10	27 91	(0 94)
Loans	22 66	9 46	13.54	12.69	26.83	10 71
Real Estate Loans	10 44	11 65	12 21	14 37	17 24	7 95
Loan Loss Reserve	0.59	0.57	(0.05)	(0 12)	2.16	1 55
Noncurrent Loans	0 26	1 11	(0 16)	1 14	1 95	3 57
Noncurrent Real Estate Loans	0 49	0 84	0 62	0 64	1 04	2 48
Other Real Estate Owned	0 06	0.34	0 32	0 78	0 42	1 92
Restructured Loans	n/a	(0.06)	0 03	0 03	0 04	0 74
Equity Capital	2.43	2 00	3 20	3 41	0 49	0 48
Primary Capital	3 07	2.55	3 18	3.23	2.53	2 02

Industry and Financial Analysis

Aggregate Performance Statistics for National Banks
(Data Through September 30, 1990)

	Under $300M		$300-$1B		$1B-$10B		Over $10B		Total	
	9 30 89	9 30 90	9 30 89	9 30 90	9 30 89	9 30 90	9 30 89	9 30 90	9 30 89	9 30 90
[illegible]										
Number of Banks	3 702	3 493	282	300	186	179	31	34	4 201	4 006
Number of Banks with Losses	548	484	25	32	15	26	4	9	592	551
Number of Failed Banks	74	82	9	3	3	1	0	0	86	86
Income Statement ($Billions)										
Year-To-Date										
Net Income	1 62	1 60	0 82	0 87	3 88	2 56	3 98	2 42	10 30	7 44
Net Operating Cash Flow	2 47	2 39	1 49	1 64	7 79	8 38	8 42	8 29	20 16	20 69
Net Interest Income	7 79	7 58	4 23	4 55	18 29	17 66	19 65	20 40	49 96	50 19
Noninterest Income	1 93	1 90	1 25	1 31	7 37	9 00	13 05	13 18	23 60	25 40
Noninterest Expense	6 54	6 43	3 61	3 89	16 57	17 32	21 79	23 73	48 51	51 37
Loan Loss Provision	0 89	0 84	0 68	0 78	3 99	5 90	4 91	5 99	10 48	13 51
Net Loan Loss	0 72	0 64	0 53	0 61	3 20	4 51	4 18	7 83	8 63	13 59
Third Quarter										
Net Income	0 64	0 58	0 21	0 21	1 30	0 62	(0 15)	0 15	2 00	1 56
Net Operating Cash Flow	0 88	0 81	0 47	0 53	3 00	2 93	2 67	2 51	7 02	6 78
Net Interest Income	2 48	2 50	1 43	1 50	6 23	6 22	6 45	6 67	16 59	16 89
Noninterest Income	0 67	0 64	0 49	0 37	2 72	3 15	4 38	4 27	8 26	8 44
Noninterest Expense	2 03	2 10	1 29	1 28	5 62	6 18	7 42	7 89	16 36	17 45
Loan Loss Provision	0 26	0 25	0 27	0 31	1 72	2 33	2 99	2 37	5 24	5 27
Net Loan Loss	0 16	0 20	0 19	0 21	1 19	1 61	1 20	1 78	2 74	3 81
Performance Ratios (%)										
Year-To-Date										
Return on Equity	10 52	10 31	11 49	11 05	13 67	9 07	12 36	6 85	12 39	8 57
Return on Assets	0 86	0 86	0 77	0 77	0 82	0 55	0 62	0 35	0 73	0 51
Net Interest Income to Assets	4 12	4 06	4 01	4 02	3 89	3 81	3 06	2 92	3 55	3 43
Loss Provision to Assets	0 47	0 45	0 65	0 69	0 85	1 27	0 77	0 86	0 75	0 92
Noninterest Income to Assets	1 02	1 02	1 19	1 16	1 57	1 94	2 03	1 89	1 68	1 74
Noninterest Expense to Assets	3 46	3 45	3 43	3 44	3 52	3 73	3 40	3 40	3 45	3 51
Real Estate Loans to Loans	47 96	49 94	42 89	45 57	35 58	37 13	32 66	36.13	36 20	38 71
Nncurrent Loans to Loans	2 23	2 08	2 20	2 25	2 31	3 14	4 42	4 61	3 26	3 67
Noncurrent RE Loans to RE Loans	1 96	1 81	2 67	2 59	3 24	4 53	3 55	5 47	3 13	4 39
Loss Reserve to Loans	1 68	1 68	1 73	1 86	1 89	2 39	3 17	2 82	2 44	67 54
Loss Reserve to Noncurrent Loans	75 37	81 01	78 69	82 73	81 60	76 05	71 71	61 18	74 80	2 48
Net Loan Loss to Loans	0 68	0 61	0 77	0 84	1 01	1 46	0 99	1 70	0 94	1 43
Loss Provision to Net Loan Loss	124 88	131 23	130 17	128 50	124 62	130 82	117 37	76 54	121 46	99 46
Equity Capital to Assets	8 21	8 35	6 80	7 01	6 12	6 23	5 01	5 17	5 94	6 05
Primary Capital to Assets + Reserves	9 09	9 22	7 87	8 14	7 40	7 75	7 34	7 30	7 63	7 75

Industry and Financial Analysis

Aggregate Performance Statistics for National Banks
(Data Through September 30, 1990)

	Under $300M		*$300-$1B*		*$1B-$10B*		*Over $10B*		*Total*	
	9/30/89	*9/30/90*	*9/30/89*	*9/30/90*	*9/30/89*	*9/30/90*	*9/30/89*	*9/30/90*	*9/30/89*	*9/30/90*
Balance Sheet ($Billions)										
Total Assets	256.56	253.82	143.24	155.13	645.63	624.63	875.69	945.49	1,921.11	1,979.07
Total Deposits	225.94	224.00	118.17	130.36	480.85	477.03	618.88	694.00	1,443.84	1,525.39
Total Liabilities	235.49	232.62	133.50	144.25	606.03	585.66	831.86	896.64	1,806.88	1,859.17
Volatile Liabilities	32.44	30.64	25.55	24.80	156.90	133.23	221.34	209.87	436.23	398.53
Total Loans	144.67	142.09	93.09	99.26	439.37	415.39	578.80	629.24	1,255.94	1,285.99
Real Estate Loans	69.38	70.96	39.93	45.23	156.30	154.23	189.03	227.37	454.64	497.79
Commercial & Industrial Loans	31.52	29.37	22.08	22.51	123.98	115.21	209.19	220.75	386.75	387.84
Loans to Individuals	31.18	29.96	23.94	24.22	110.15	103.91	77.26	79.62	242.53	237.70
Noncurrent Loans	3.23	2.95	2.05	2.23	10.16	13.05	25.56	29.01	41.00	47.24
Noncurrent Real Estate Loans	1.36	1.28	1.07	1.17	5.07	6.98	6.72	12.44	14.21	21.87
Other Real Estate Owned	1.70	1.51	0.71	0.88	2.48	4.18	3.10	6.06	7.99	12.62
Restructured Loans	0.58	0.48	0.18	0.15	0.30	0.57	0.32	2.39	1.38	3.60
Loan Loss Reserve	2.43	2.39	1.61	1.85	8.29	9.93	18.33	17.75	30.67	31.91
Equity Capital	21.06	21.20	9.74	10.88	39.52	38.90	43.84	48.85	114.15	119.83
Primary Capital	23.54	23.62	11.41	12.78	48.41	49.16	65.66	70.33	149.01	55.89
Balance Sheet Changes ($Billions)										
Year-To-Date Gains (Losses)										
Assets	(4.74)	(4.92)	1.10	9.46	36.30	(44.86)	42.27	43.43	74.93	3.11
Loans	(0.22)	(1.77)	1.89	5.52	31.75	(34.06)	28.41	36.35	61.82	6.04
Real Estate Loans	1.86	1.39	2.13	5.21	16.75	(6.16)	26.28	31.14	47.02	31.57
Loan Loss Reserve	(0.08)	(0.01)	0.06	0.22	0.60	0.42	0.26	(1.08)	0.84	(0.45)
Noncurrent Loans	(0.05)	0.00	0.20	0.39	1.54	2.20	3.26	3.66	4.94	6.25
Noncurrent Real Estate Loans	(0.09)	(0.01)	0.10	0.27	1.19	1.17	2.41	4.58	3.60	6.00
Other Real Estate Owned	(0.18)	(0.17)	(0.05)	0.16	0.29	1.16	1.18	2.26	1.25	3.41
Restructured Loans	(0.05)	(0.09)	(0.02)	(0.01)	(0.07)	0.18	(0.01)	2.17	(0.15)	2.25
Equity Capital	0.60	0.46	0.59	1.06	3.42	0.32	1.38	4.35	6.00	6.20
Primary Capital	0.54	0.43	0.66	1.28	4.06	0.48	1.46	3.51	6.73	5.70
Third Quarter Gains (Losses)										
Assets	(2.21)	(1.02)	5.47	1.31	15.62	15.77	9.04	(16.99)	27.91	(0.94)
Loans	(1.26)	(0.33)	2.51	0.91	14.24	10.65	11.34	(0.52)	26.83	10.71
Real Estate Loans	0.05	0.53	1.46	0.80	8.81	7.52	6.93	(0.89)	17.24	7.95
Loan Loss Reserve	(0.10)	0.01	0.15	0.06	0.51	0.86	1.60	0.61	2.16	1.55
Noncurrent Loans	(0.12)	0.10	0.30	0.23	1.09	1.65	0.68	1.59	1.95	3.57
Noncurrent Real Estate Loans	(0.10)	0.06	0.16	0.12	0.63	0.84	0.34	1.45	1.04	2.48
Other Real Estate Owned	(0.25)	(0.03)	0.12	0.04	0.38	0.86	0.17	1.05	0.42	1.92
Restructured Loans	(0.01)	(0.03)	(0.01)	(0.01)	0.01	(0.07)	0.05	0.85	0.04	0.74
Equity Capital	0.28	0.14	0.18	0.03	0.81	0.99	(0.78)	(0.68)	0.49	0.48
Primary Capital	0.18	0.15	0.32	0.10	1.34	1.87	0.68	(0.10)	2.53	2.02

Industry and Financial Analysis

Aggregate Performance Statistics for National Banks

(Data Through September 30, 1990)

	Under $300M		*$300-$1B*		*$1B-$10B*		*Over $10B*		*Total*	
	9 30 89	*9 30 90*	*9 30 89*	*9 30 90*	*9 30 89*	*9 30 90*	*9 30 89*	*9 30 90*	*9 30 89*	*9 30 90*
Industry Structure										
Number of Banks	3,702	3,493	282	300	186	179	31	34	4,201	4,006
Number of Banks with Losses	548	484	25	32	15	26	4	9	592	551
Number of Failed Banks	74	82	9	3	3	1	0	0	86	86
Income Statement ($Billions)										
Year-To-Date										
Net Income	1 62	1 60	0 82	0 87	3 88	2 56	3 98	2 42	10 30	7 44
Net Operating Cash Flow	2 47	2 39	1 49	1 64	7 79	8 38	8 42	8 29	20 16	20 69
Net Interest Income	7 79	7 58	4 23	4 55	18 29	17 66	19 65	20 40	49 96	50 19
Noninterest Income	1 93	1 90	1 25	1 31	7 37	9 00	13 05	13 18	23 60	25 40
Noninterest Expense	6 54	6 43	3 61	3 89	16 57	17 32	21 79	23 73	48 51	51 37
Loan Loss Provision	0 89	0 84	0 68	0 78	3 99	5 90	4 91	5 99	10 48	13 51
Net Loan Loss	0 72	0 64	0 53	0 61	3 20	4 51	4 18	7 83	8 63	13 59
Third Quarter										
Net Income	0 64	0 58	0 21	0 21	1 30	0 62	(0 15)	0 15	2 00	1 56
Net Operating Cash Flow	0 88	0 81	0 47	0 53	3 00	2 93	2 67	2 51	7 02	6 78
Net Interest Income	2 48	2 50	1 43	1 50	6 23	6 22	6 45	6 67	16 59	16 89
Noninterest Income	0 67	0 64	0 49	0 37	2 72	3 15	4 38	4 27	8 26	8 44
Noninterest Expense	2 03	2 10	1 29	1 28	5 62	6 18	7 42	7 89	16 36	17 45
Loan Loss Provision	0 26	0 25	0 27	0 31	1 72	2 33	2 99	2 37	5 24	5 27
Net Loan Loss	0 16	0 20	0 19	0 21	1 19	1 61	1 20	1 78	2 74	3 81
Performance Ratios (%)										
Year-To-Date										
Return on Equity	10 52	10 31	11 49	11 05	13 67	9 07	12 36	6 85	12 39	8 57
Return on Assets	0 86	0 86	0 77	0 77	0 82	0 55	0 62	0 35	0 73	0 51
Net Interest Income to Assets	4 12	4 06	4 01	4 02	3 89	3 81	3 06	2 92	3 55	3 43
Loss Provision to Assets	0 47	0 45	0 65	0 69	0 85	1 27	0 77	0 86	0 75	0 92
Noninterest Income to Assets	1 02	1 02	1 19	1 16	1 57	1 94	2 03	1 89	1 68	1 74
Noninterest Expense to Assets	3 46	3 45	3 43	3 44	3 52	3 73	3 40	3 40	3 45	3 51
Real Estate Loans to Loans	47 96	49 94	42 89	45 57	35 58	37 13	32 66	36 13	36 20	38 71
Nncurrent Loans to Loans	2 23	2 08	2 20	2 25	2 31	3 14	4 42	4 61	3 26	3 67
Noncurrent RE Loans to RE Loans	1 96	1 81	2 67	2 59	3 24	4 53	3 55	5 47	3 13	4 39
Loss Reserve to Loans	1 68	1 68	1 73	1 86	1 89	2 39	3 17	2 82	2 44	67 54
Loss Reserve to Noncurrent Loans	75 37	81 01	78 69	82 73	81 60	76 05	71 71	61 18	74 80	2 48
Net Loan Loss to Loans	0 68	0 61	0 77	0 84	1 01	1 46	0 99	1 70	0 94	1 43
Loss Provision to Net Loan Loss	124 88	131 23	130 17	128 50	124 62	130 82	117 37	76 54	121 46	99 46
Equity Capital to Assets	8 21	8 35	6 80	7 01	6 12	6 23	5 01	5 17	5 94	6 05
Primary Capital to Assets + Reserves	9 09	9 22	7 87	8 14	7 40	7 75	7 34	7 30	7 63	7 75

Industry and Financial Analysis

Aggregate Performance Statistics for National Banks
(Data Through September 30, 1990)

	Northeastern	*Southeastern*	*Central*	*Midwestern*	*Southwestern*	*West*	*Multinational*	*Total*
Balance Sheet ($Billions)								
Total Assets	394 24	268 33	284 09	106 69	144 98	174 67	606 07	1 979 07
Total Deposits	308 25	208 11	221 47	86 19	122 50	139 89	438 98	1 525 39
Total Liabilities	372 22	250 04	264 02	99 27	135 49	162 60	575 52	1 859 17
Volatile Liabilities	79 38	55 44	58 23	17 23	27 47	32 12	128 66	398 53
Total Loans	254 37	174 73	178 90	63 50	73 51	123 20	417 78	1,285 99
Real Estate Loans	100 88	81 80	63 12	21 48	29 07	52 80	148 65	497 79
Commercial & Industrial Loans	78 58	40 03	58 63	18 63	21 81	34 24	135 92	387 84
Loans to Individuals	41 36	37 71	38 83	13 31	13 78	23 14	69 56	237 70
Noncurrent Loans	12 46	3 81	3 69	1 10	3 00	3 12	20 06	47 24
Noncurrent Real Estate Loans	7 15	2 42	1 26	0 43	1 72	1 45	7 45	21 87
Other Real Estate Owned	3.06	1 17	0 68	0 33	1 99	1 25	4 14	12 62
Restructured Loans	0 55	0 09	0 33	0 13	0 44	0 19	1 87	3 60
Loan Loss Reserve	8 17	2 99	2 88	1 20	2 33	2 64	11 70	31 91
Equity Capital	22 02	18 29	20 07	7 42	9 49	12 07	30 47	119 83
Primary Capital	31 20	21 63	23 01	8 81	11 83	15 22	44 21	155 89
Balance Sheet Changes ($Billions)								
Year-To-Date Gains (Losses)								
Assets	(5 73)	3 45	6 81	0 34	(9 63)	4 21	3 66	3 11
Loans	(12 03)	3 71	10 87	(0 01)	(6 85)	4 09	6 25	6 04
Real Estate Loans	2 68	5 01	6 30	1 76	(2 25)	4 52	13 56	31 57
Loan Loss Reserve	0 70	0 46	0 42	0 03	(0 42)	0 17	(1 80)	(0 45)
Noncurrent Loans	3 89	1 29	1 06	0 11	(2 28)	0 23	1 95	6 25
Noncurrent Real Estate Loans	2 92	0 94	0 45	0 13	(1 30)	(0 06)	2 92	6 00
Other Real Estate Owned	1.91	0 46	0 22	0 06	(1 60)	0 26	2 10	3 41
Restructured Loans	0.34	(0 05)	0 11	(0 02)	0 11	(0 01)	1 77	2 25
Equity Capital	0 21	0 87	1 18	0 35	2 09	0 80	0 70	6 20
Primary Capital	0 88	1 33	1 61	0 37	1 66	0 98	(1 12)	5 70
Third Quarter Gains (Losses)								
Assets	0 08	(0 16)	0 80	0 66	(1 61)	(0 53)	(0 19)	(0 94)
Loans	(0 57)	1 16	3 44	0 03	(0 13)	(0 32)	7 11	10 71
Real Estate Loans	0 72	1 48	1 68	0 21	0 03	1 31	2 52	7 95
Loan Loss Reserve	0 79	0 19	0 14	0 00	(0 06)	0 03	0 45	1 55
Noncurrent Loans	1 46	0.34	0 39	0 03	(0 10)	0 24	1 21	3 57
Noncurrent Real Estate Loans	0 86	0 24	0 22	0 01	0 02	0 10	1 02	2 48
Other Real Estate Owned	0 80	0 19	0 01	0 02	(0 09)	0 09	0 91	1 92
Restructured Loans	(0 06)	(0 04)	(0 02)	(0 01)	(0 02)	(0 02)	0 89	0 74
Equity Capital	(0 06)	0 05	0 31	0 12	0 01	0 31	(0 25)	0 48
Primary Capital	0 71	0 24	0 45	0 13	(0 05)	0 34	0 19	2 02

Industry and Financial Analysis

The Outlook for Banking: Dour or Dire?

The most important thing I have learned about working in Washington is the importance of reputation in politics. A good reputation will open doors and minds. A poor reputation will slam both shut. Reputation can make a career in Washington. Reputation can also bring a career in Washington to a sudden end.

In the early years of this century, Phil Campbell was a powerful congressman from Kansas — a party whip in the House and Chairman of the Rules Committee. But he made an unconscious and politically fatal mistake. He bought a house in Virginia.

Naturally, he paid Virginia real estate taxes. One item in his tax bill was $1.50 for the state poll tax. The Congressman, without noticing this item, had his secretary pay the whole bill. Then, as usual, he ran for reelection back in Kansas.

His opponent dug up the Virginia poll tax receipt, had it copied, and distributed it to Kansas voters as proof that Campbell had so little regard for them that he had become a legal resident of Virginia.

Indeed, at Campbell's final campaign rally, the opposition induced the Congressman's own band to play, as a final number, "Carry Me Back to Ole Virginny."

His reputation destroyed by a trivial mistake, Campbell was defeated.

Reputation is just as important in Washington after an election as it is during one. Government decision makers — for example, the Congress — deal with many wide ranging questions of such great complexity that answers do not immediately suggest themselves. Decision makers must then rely on the professional judgments of others. And that makes politics a people business.

A reputation for competence, for good faith, and for honesty is necessary if you want to be taken seriously in Washington. A reputation for something less than competence, hidden motives, and duplicity may not destroy you, but it will destroy your opportunity to participate in the great debate that our federal government was designed to ensure and promote.

Remarks by Robert L. Clarke, Comptroller of the Currency, before the American Bankers Association Annual Convention, Orlando, Florida, October 23, 1990

As your presence at this convention shows, you consider yourselves to be part of an industry. The image of that industry, as a whole, is more tarnished today than it has been in a half century.

I grant you that part of the problem can be attributed to forces beyond the banking industry's control: fallout from the savings and loan crisis and the FSLIC blowout.

However, just as sure as regulation follows legislation, banking's image — tarnished or polished — will shape the way you do business in your individual institutions. Your public image is likely to determine the outcome of legislative debates next year on the future of banking.

One part of banking's image as an industry is how the public views its safety and soundness. Another part of banking's image is how the public views the industry's credibility.

Focusing first on safety and soundness, I quote from a recent article in the *American Banker's* seventh annual survey of consumer attitudes, *What Consumers Want*:

> 35 percent of the public believe the banking system is unhealthy. The reading was up from 30 percent a year earlier and was the worst since the survey series began in 1984. In every survey since 1985 — with the notable exception of 1988, when Americans prepared to choose a new president — confidence in the financial system has been drifting downward. The erosion of confidence has become especially pronounced with growing awareness of the magnitude of the savings and loan debacle and the multibillion-dollar bailout program that began in 1989.

You can interpret these statistics any way that you want to.

The *American Banker* summed up its interpretation in the title of the article, a title that read: "Confidence Sags Along with Health of the Banking System."

Along with the sag in public confidence, the industry is also experiencing a sag in its credibility. And, unfortunately, for good reason.

The industry — as an industry — has been drawing down its credibility.

There are no simple quantitative measures of that erosion. But no one can doubt that the industry has lost credibility with investment analysts. It has lost credibility with stockholders and investors. It has lost credibility with the General Accounting Office and with the Congress. This erosion of credibility is placing tremendous strain on the supervisory process. And one major reason for this erosion is that banks have done too little and have been too late in acknowledging their losses. As a result, Wall Street has little faith in what the banks report.

You do not have to take my word for it. Consider what Thomas Hanley, a Salomon Brothers managing director and banking analyst has to say: "Even bad news correctly reported would raise the banks' multiples."

That is about as low as you can go.

I believe that an important part of bank supervision is to speak out when I see a problem. And even to warn of possible problems if signs are pointing in that direction. Closing our eyes to problems or possible problems will not make them go away. Neither will they disappear if we do not talk about them.

In years past, I have taken the opportunity this podium affords to talk about — indeed, to warn you about — the most immediate danger for banking from my perspective.

I talked about increasing competition from abroad. It has increased dramatically — and it continues to.

I talked about competition from other financial service providers. It has grown — and it continues to.

Two years ago, I warned that the collapse of the savings and loan industry and the bankruptcy of its deposit insurance fund would have significant, sustained, and costly repercussions for banking and the bank insurance system. The repercussions came — and they continue to.

Further, anyone in touch with reality would have to agree that those two events — the S&L industry's collapse and the S&L deposit insurance fund's bankruptcy — continue to haunt all discussions of the financial system today.

That may not be fair. That may not be right. But you cannot change reality by refusing to talk about it.

Reeling from the savings and loan disasters and smarting from the resulting blow to their pocketbooks, U.S. taxpayers — the voters — who all together form the American public — are angry. They take every opportunity to vent that anger on their elected representatives and government officials. They want — absolutely and positively — no similar disaster visited upon them by the commercial banks. As a result, in Washington today, the entire legal and regulatory structure for banking is being questioned.

In politics — and in Washington — it does not matter whether the perception of the banking industry is fair or not.

The distinction is irrelevant.

In politics — and in Washington — perception is reality.

In politics — and in Washington — once you have lost public confidence — once you have lost your credibility — you have lost everything.

Take a moment to think about banking's reputation in the past. That reputation was reflected in cliches of the day. Remember when people used to say: "It's as safe as money in the bank?" Remember when people used to say: "It's as solid as the bank on the corner?"

Banking had that kind of reputation — safe, solid — for decades, but it did not happen by accident.

It resulted from three factors:

One, a generation of bankers who had an institutional vision — a concern for the bank as a going concern not only in the next quarter but into the next year and the next decade — and who made decisions and plans accordingly.

Two, a generation of bankers who had a concern for the basics: sound lending practices and diversification of risks. And, three, a system of federal deposit insurance that provided the banking system with an anchor in public confidence, an anchor designed to stabilize the system in dangerous times.

How do you restore banking's tarnished reputation? The answer lies in how the banking industry achieved its polished reputation in the first place. The answer is both easy and hard. Easy to state. Hard to achieve. The answer is simply to restore the institutional vision and to do the basics — do them well — and do not cut corners.

You cannot build a strong structure on a weak foundation.

You cannot build market share without an adequate capital base.

You cannot hire expertise if you do not have money to pay for it.

Without capital, you cannot take advantage of opportunities as they arise — opportunities that range from generating new business in Europe to purchasing a branch from the Resolution Trust Corporation.

One fundamental of banking is to avoid concentration — or protect against loss from concentration — in the loan portfolio.

As you know, the OCC's interest in real estate lending was triggered several years ago when we became concerned with the dramatic growth in real estate lending over the latter half of the 1980s and the resulting concentration of real estate loans in the portfolios of banks. We made no secret of our concern. We began talking about it three years ago.

Considering the reaction — or rather, lack of reaction — from the industry, we should have fired rockets and sounded sirens.

Why were we concerned?

Concentration in lending to any industry or market segment — real estate, shipping, energy, agriculture, what have you — increases the exposure of the lending institutions to downturns in the business of those borrowers.

It's like putting all, or most, of your eggs in one basket. Nothing may happen to the basket. But if something does, your eggs are in greater peril than if you spread them around to other baskets in the first place.

As you know, our concern grew as real estate markets throughout the country began to soften. And no one knows better than national banks that the OCC has spent the last 18 months focusing on, and assessing the damage to, real estate loans held by money center and regional banking institutions.

However, I note today that concentration in real estate lending is not limited to the nation's larger banking institutions. Small banks and medium-sized banks evidence concentration in real estate as well.

Measured in dollars, almost half of the loans at the nation's 583 banks with assets between $300 million and $1 billion are in real estate.

Fully half of the loans at the nation's banks with assets of less than $300 million are in real estate. More than 11,000 banks in the U.S. have assets of less than $300 million.

By contrast, the nation's largest banks — those with more than $10 billion in assets — had slightly less than a third of their total loan portfolios in real estate loans at the end of June

And those 313 banks with assets of between $1 billion and $10 billion had a bit more than a third of their total loan portfolios — about 37 percent — in real estate loans on the same date.

Now it is true that banking covers a multitude of markets, just as the term "real estate" covers a multitude of assets.

Just as the larger institutions leaned heavily toward lending to commercial real estate projects in large urban areas, smaller institutions lean heavily toward residential housing everywhere.

But avoiding concentration is a fundamental of banking that goes beyond the immediate condition of the asset, whether the market is strong or weak at any particular time. It is a fundamental that bankers and bank supervisors must keep in mind in good times as well as bad

All of our examiners — for small banks as well as large — have been given guidance to pay particular attention to real estate concentrations. Therefore, when OCC examiners follow that guidance, it should come as no surprise to bankers at any national bank, regardless of size or location.

Recent experience has again brought home the lesson that there is no substitute for following the fundamentals.

A good reputation accumulates routinely. It is built up, not manufactured. This is far from profound advice and it is certainly not original to me. But, as banking's current reputation proves, profound damage occurs from the failure to follow it.

Banking as an industry must now focus on damage control, whether it wants to or not.

Throughout the history of the United States, the critics of banking — those who have sought and will continue to seek to constrict competitive opportunities for banking — have leaned on two main premises in building arguments to promote their legislative ends

One, that the industry is too crucial to the nation's economic well-being to leave to the bankers. And, two, that bankers are too greedy or too inept to be left to their own devices.

Today, we are witnessing the use of a third premise by banking's critics, and that is that bankers, if left unchecked, will quickly bankrupt the deposit insurance

fail and cost the taxpayer astronomical, and, as yet, untold sums of money.

Even in the days when the public evidenced its faith in banking with the statement "as safe as money in the bank," bankers were rarely accorded warmth and affection from the man in the street.

Indeed, much of the regulation that has adhered to banking — in the U.S. and elsewhere — and it is considerable — has arisen from distrust in the motives and capabilities of bankers.

Bankers don't have a reservoir of public goodwill from which to draw.

This is a harsh assessment, I recognize, but this is not a time to be kidding ourselves.

As I noted just a moment ago, the entire legal and regulatory structure for banking is being questioned. And it is being questioned in no small part because the taxpayer refuses to allow a repeat of the thrift crisis, as does everyone in this room. The banking industry joins the discussion of its structure — not from a position of strength — but from a position of weakness. Your reputation as an industry may not do you justice — but in Washington that doesn't matter because perception is reality.

The discussion in Washington on banking's future really comes down to one question: Do we need the banking system we have now?

If the answer is "yes," a number of alternatives suggest themselves.

Changing the laws to make commercial banks more competitive by widening the product line they are allowed to offer and by erasing remaining geographic restraints.

Or imposing new regulation on the industry to make sure bankers have less opportunity to get into trouble.

Or, finding a new balance between these two extremes.

But note: None of these would be radical changes. Any of these alternatives would simply be an effort to reengineer the existing system.

Consider, however, another outcome.

What if the answer is no, we do not need the banking system we now have?

Let me make it very clear that I am not advocating that response. On the contrary, I believe very strongly that this country needs a solid, competitive banking system, and that the future for banking can be very bright.

But those who answer the question no — we do not need the banking system we now have — will argue that, with the exception of federal insurance for deposits, some other type of financial institution today offers every service that banks, savings and loans, and credit unions offer. Those same advocates would argue that there is certainly nothing unique — much less sacred — about the banking system we have now. Congress created it. Congress can alter it. And Congress can construct a new system altogether.

This last prospect is sobering. But it is not impossible.

The outcome of that debate is in your hands.

Commercial Bank Involvement in the Economic Transformation of Eastern Europe: Opportunities and Risks

Events in Eastern Europe in the late 1980s, during which the authoritarian political systems from Poland in the north to Bulgaria in the south gave way to more open, democratic governments, have led to an overall sense of euphoria among political commentators. However, while the region's political emancipation has been relatively orderly, the economic transformation of Eastern Europe from centrally planned economies to free market experiments poses greater challenges. Central to these new challenges is a desperate need of foreign capital; this need raises questions about the role western commercial banks are likely to play in Eastern Europe's economic and financial reformation.

U.S. Commercial Bank Exposure in Eastern Europe

Eastern Europe represents a potential market for U.S bankers. To date, however, there has not been a rush on the part of U.S. banks to exploit business opportunities in the region. Instead, U.S. commercial bank exposure to Eastern European countries has fallen radically since 1982. This trend has continued even during the last one and one-half years.

U.S. Commercial Bank Exposure in Eastern Europe
(U.S. dollars in billions)

	June 1982	*December 1988*	*June 1989*	*December 1989*	*June 1990*
Bulgaria	234	149	109	63	57
Czechoslavakia	195	30	49	35	29
G.D.R.	901	325	274	235	306
Hungary	887	311	262	240	250
Poland	1121	288	282	287	296
Romania	248	41	4	0	0
U.S.S.R.	362	490	355	451	323
Yugoslavia	2450	1752	1631	1428	1273
Total	6397	3386	2966	2739	2534

Source: Country Exposure Lending Survey

U.S. commercial bank exposure to Eastern Europe has declined for three major reasons. Most importantly, the majority of U.S. banks already have been or are in the process of exiting from international lending in general. The domestication of U.S. bank portfolios is largely related to the adverse experiences of U.S. banks in the developing world's debt crisis in the 1980s, to the need to raise capital levels to meet capital adequacy ratios agreed upon by the Basle Committee, and to the troubled nature of credit concentrations such as lending in the areas of real estate and highly leveraged transactions (HLTs). These factors, together with vigorous European and Japanese competition in international markets, have left many U.S. commercial banks with little appetite for potentially "high risk" ventures such as in Eastern Europe.

What, then, <u>are</u> U.S. banks doing in Eastern Europe? It would be mistaken to conclude that the region's pending transformation from socialist backwater to a new capitalist headwater has gone unnoticed by U.S. commercial banks. Indeed, while exposure has declined, a number of larger U.S. banks are seeking fee income advisory business in selected Eastern European countries. This involves establishing offices to help corporate customers find local business partners, assisting in the creation of joint ventures and arranging investment related financings, providing trade finance, and helping to privatize government-owned companies.[1]

Western European and Japanese Commercial Bank Exposure in Eastern Europe

While U.S. commercial banks retain a limited interest in Eastern Europe, the bulk of the external debt of Eastern Europe and the Soviet Union is held by European and Japanese banks. Bulgaria is illustrative of an Eastern European country burdened by external debt obligations. It was forced to freeze payments on its external

[1] *James R. Krause, "Poland Gives Nod to 4 Foreign Banks,"* The American Banker, *July 19, 1990, p. 10; "Soviet Union and Eastern Europe: Gulf Conflict Ups and Downs,"* Petroleum Economics, *September 1990, p. 35; Clyde Haberman, "Bulgaria and Neighbors in East Bloc Are Reeling After Cuts in Soviet Oil,"* The New York Times, *November 14, 1990, p. A12; Judy Dempsey, "Lights going dim in eastern Europe,"* Financial Times, *August 5, 1990, p. 2[illegible]*

debt of $1[illegible] billion in June 1990, thereby joining Poland and Yugoslavia in the ranks of troubled Eastern European debtors seeking to reschedule external debt. Excessive overborrowing by the former Bulgarian regime in the late 1980s and economic mismanagement were largely to blame for the current problems which worsened in 1990 due to the Persian Gulf crisis, which is currently expected to cost Bulgaria between $4-6 billion in higher energy prices and lost revenues.[2] Bulgaria published data about the structure of its foreign debt for the first time in August 1990. the debt is owed to 200 commercial banks, with the largest exposures held by German ($1.8 billion), Japanese ($1.4 billion), Austrian ($1 billion), and British ($1 billion) banks.[3] U.S. exposure to Bulgaria was reported to be a relatively modest $59 million spread among six banks.

The most significant bankers in Eastern Europe have been the Germans, Japanese, Swiss, Austrians, and French. For the Western Europeans, especially the Germans, Eastern Europe is a natural and traditional market. Moreover, the reunification of Germany in 1990 and concerns about new waves of Eastern European economic refugees have led the Federal Republic's government on some occasions to use German banks as extensions of foreign policy.

As a result, German banks, armed with government guarantees, have been active in lending to the Soviet Union and other countries such as Hungary. In July 1990 a consortium of German banks, led by Deutsche Bank and Dresdner Bank, provided a DM 5 billion loan to the Soviet Union to help that country pay back its trade bills. The Soviets received another DM 1.2 billion loan in September 1990 extended by a consortium of 55 German banks and a full guarantee of Hermes, the German export credit insurance bank. In 1990, when the Soviet Union had a hard currency shortage, German banks again came to the rescue, putting together a five billion DM ($2.98 billion) credit which was guaranteed by the Federal Republic. According to Bank for International Settlement (BIS) data, a rough estimate of German commercial bank outstandings in Eastern Europe and the Soviet Union is between $33-36 billion as of year-end 1989.

[2] Richard Phillips, "U.S. Banks Steering Clear of Eastern Europe," The International Economy, *October/November 1990*, p. 33.

[3] "Banks Meet to Work Out Bulgaria's Foreign Debt," LDC Debt Report/Latin American Markets, *August 13, 1990*, p. 4.

Eastern European Hard Currency
Debt With Reporting BIS Banks
(U.S. dollars in millions)

	December 1982	December 1987	December 1988	December 1989	March 1990
Albania	85	83	113	392	288
Bulgaria	944	5 364	6 879	7 757	7 557
Czechoslovakia	668	4 236	4 466	5 155	5 153
G.D.R.	1 748	14.063	16 013	16 999	16 783
Hungary	613	12 381	11 480	11.897	11 469
Poland	813	12 252	10.551	10 282	10.408
Romania	283	2.547	745	248	283
U.S.S.R.	9.693	33.343	36.853	44 842	45 464
Total	14.932	84.269	87.100	97 572	97.405

It appears from the survey that while commercial bank lending peaked in December 1989, it had fallen off by March 1990, although overall external debt in the region continued to grow. The cooling of Western European enthusiasm for lending to the East was expressed by the chairman of Lloyds Bank Plc, who stated on March 26, 1990, "Openings are possible in investment banking for projects and financial services, but I see few prospects for commercial banks."[4]

Total Eastern Europe Hard Currency Debt, 1989
(U.S.dollars in billions)

Soviet Union	*53*
Poland	*40*
Yugoslavia	*18*
Romania	*1*
East Germany	*21*
Czechoslovakia	*7*
Hungary	*20*
Bulgaria	*10*
Total	*170*

Source: Deutsche Bank

Economic Conditions in Eastern Europe

The ebbing of European and Japanese commercial bank lending is likely to continue as many East European countries such as Hungary and Czechoslovakia take advantage of cheaper credits made available by the World Bank and, in the future, the new European Bank for Reconstruction and Development. On the banks' part, the risks posed by the political and economic transformations occurring in Eastern European are likely to heighten concern about expanding lending in the East.

[4] *Reuter, March 26, 1990*

The increasing wariness about Eastern Europe's creditworthiness was reflected in the decision by Moody's Investors Service in July 1990 to downgrade the National Bank of Hungary from Baa2 to Ba1. The rating agency provided three reasons for this decision: the rapid collapse of communist regimes had accelerated and increased the needs for resources to rebuild the region; economic and political crises had intensified payments difficulties which made private lenders reluctant to continue to increase their credit exposure; and the unraveling of the Council for Mutual Economic Assistance (Comecon) was expected to hurt growth and increase unemployment.[5] Thus, despite Hungary's serious efforts to achieve economic reform, the increased needs in the rest of the region, which has put pressure on capital markets, combined with the debt servicing problems of Bulgaria and Poland, has done little to bolster banker confidence in Hungary or other Eastern European countries.

In sum, as Moody's and other observers have noted, there are risks as well as opportunities to commercial bank lending in Eastern Europe. The most obvious risk is the magnitude of the task that Eastern European countries and the Soviet Union have embarked upon. Privatizing will be the most difficult undertaking these countries must confront in many decades.

Privatizing the financial services sectors in Eastern Europe will be difficult in that most of the region's legal and regulatory systems have no tradition of competition among financial institutions capable of assessing and providing financial services, nor do they have recent experience with upholding the rights of private property. Under the communist system, financial sectors were owned and managed by the state with little or no competition among institutions. Regulators often intervened in banking matters, functioning as participants in the system. With the introduction of market mechanisms, however, Eastern European regulators find themselves in unfamiliar territory in which they are now expected to supervise a hitherto unknown competitive system without actively participating in the system.

Recent macroeconomic trends, such as higher oil prices, have also disadvantaged Eastern Europe as a source of foreign investment for international banks. The ongoing Persian Gulf crisis and the Soviet Union's decision to cease, as of January 1, 1991, providing cheap oil to Eastern Europe, and to demand payments at market prices in hard currency, will require considerable adjustment throughout the region. The investment bank Morgan Stanley has estimated that $30 a barrel oil would absorb 20 percent of Hungary's hard currency income, 33 percent of Poland's, 90 percent of Czechoslovakia's, and more than 100 percent of Bulgaria's.[6] Since oil prices have already exceeded that price, most Eastern European countries have been forced to seek additional financing to cover widening current account deficits.

The inadequate and outmoded industrial and communications infrastructure of Eastern Europe poses another risk. Billions of dollars of new investment is required simply to update telecommunications facilities and to improve production. Questions of repayment loom over this horizon, especially as the region's largest economies, the Soviet Union's and Poland's, are expected to contract by 3.5 percent and 15 percent respectively this year.[7]

Human resources are also problematical in Eastern Europe, particularly for the development of financial services and entrepreneurial companies. The lack of a highly trained work force is exacerbated by the absence of financial and market information throughout Eastern Europe, the fact that general accounting principles are unknown, and the absence of the concept of serving the public. Among other problems, these weaknesses have prevented production of comprehensive and reliable statistics to allow governments and private sector companies to make decisions in the increasingly decentralized and open economies of Eastern Europe.

Finally, it is likely to take some time to overcome the attitudes and psychology of Eastern Europe which have for the last several decades been anti-capitalist and anti-entrepreneurial. Governmental resistance to foreign-owned projects or to the purchase of newly privatized companies by foreign entities are also risks.

Conclusion

The concern that U.S. bankers are "missing out" on the action in Eastern Europe, while their Japanese and European colleagues rush in to Eastern Europe, can be viewed in two ways. First, after the second 1990 Tokyo stock market downturn in midyear, many Japanese banks quietly began to downside their overseas activities in order to concentrate on capital adequacy ratios. Moreover, Eastern Europe is Western Europe's

[5] *Moody's Rating Service, National Bank of Hungary, July 13, 1990, p.1.*

[6] *John Evans, "Oil Price Rise May Stall East Europe Debt Payments,"* The American Banker, *August 14, 1990, p. 12.*

[7] Barclays Economic Review, *November 1990, p. 32.*

[illegible] political and economic development will inevitably receive more intensive involvement from Western European governments and banks than from the United States or Japan. Western Europeans have been conducting business in the East for a longer period of time and offer stiff competition for any newcomers such as many U.S. banks. Western Europeans also share a concern that if Eastern Europe's experiment with a democratic-capitalist model is not successful, a failure would open the door to a potential return of East-West tensions and new waves of refugees.

Accordingly, the U.S. commercial bank approach has been measured and cautious in the aftermath of the revolutions that swept Eastern Europe in 1989. The higher risks associated with Eastern Europe, with the possible exceptions of Czechoslovakia and the former East Germany, which is now part of the German Federal Republic, were demonstrated by recent Organization for Economic Cooperation and Development (OECD) data on new syndicated loans for the first eight months of 1990. Only $92 million of loans arranged had been signed as of the end of August 1990, compared with $1.3 billion in the same period of 1989, while the average spread to lenders has jumped from 53 to 82 basis points.[8] Hence uncertainties surrounding the economic and political future of Eastern Europe are likely, in the near term, to deter significant commercial bank involvement in Eastern Europe.

[8] *"Bank Lending,"* The Economist, *November 10, 1990, p. 124.*

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Litigation Update

On August 6, 1990, the Eighth Circuit Court of Appeals issued its decision in *The First National Bank of Gordon v. Department of the Treasury.* In its appeal of the cease and desist order ("order") issued by the Comptroller on June 30, 1989, the bank argued that the Comptroller's finding violated 12 U.S.C. 84 and 161 and was not based on substantial evidence. The bank also contended that the manner in which the Comptroller found that the bank had violated section 84 amounted to a denial of its right to due process of law. The Comptroller's order followed an administrative hearing which took place in July 1988.

In his decision, issued June 30, 1989, the Comptroller had found that the bank had made loans to one borrower in excess of its lending limit. The bank argued that it was entitled to two regulatory exceptions to the section 84 limits. First, the bank argued it was entitled to the "means and purpose test," found at 12 CFR 32.5(d)(1989), which permits segregation of loans to agencies and instrumentalities of foreign governments from loans to the foreign government itself when certain conditions are met. The court agreed with the Comptroller that the bank had not succeeded in showing that it is entitled to this exception. The court noted that the bank "has the burden of proof in establishing its entitlement to an exception from the statutory requirement . . . ." Moreover, the "nature and extent of proof required to show entitlement to an exception created by regulation should be, at least in the first instance, for the Comptroller to decide."

The second exemption to the lending limit relied upon by the bank was 12 CFR 32.109(b)(1989). This exception provides that loans to states and political subdivisions are not subject to any lending limit if the loan is a "general obligation" of a state or political subdivision; under 12 CFR 1.3(g)(1989), a "general obligation" is defined, in part, as an obligation supported by "the full faith and credit of an obligor possessing general powers of taxation . . . ." In his final decision, the Comptroller ruled that the bank's loans were not eligible for the exception because the full faith and credit of the borrower had not been pledged in support of its loans from the bank.

In December 1988, prior to issuance of the Comptroller's decision, the administrative law judge issued a recommended decision. Disputing portions of the recommendations, the OCC filed its exceptions one month later. The bank subsequently sought to strike the OCC's exceptions, arguing that it had not been given a sufficient opportunity to address the full faith and credit issue, which had first been explained fully in the exceptions. The Comptroller denied the bank's motion to strike but permitted the bank ten days to submit legal arguments on this issue. The bank subsequently submitted factual and legal arguments.

In its decision, the court ruled that the ten day period granted by the Comptroller was insufficient and thus constituted a denial of the bank's due process rights. The court vacated the portion of the Comptroller's order relating to 12 U.S.C. 84, remanding the case to the Comptroller "for further proceedings consistent with this opinion." The practical effect of this will be that the bank will be granted another hearing before the administrative law judge to determine whether the bank's loans are in fact eligible for the exception provided by 12 CFR 32.109(b).

The Comptroller's decision also found that the bank had violated 12 U.S.C. 161 because its call reports understated the level of its allowance for loan and lease losses. In its appeal of the decision, the bank conceded that its call reports were mistaken. It argued, however, that because the reports were "true and correct to the best of [the] knowledge and belief" of the bank officials who signed them, there was no violation of law on the part of the bank.

The court adopted the Comptroller's view, stating that the bank is obligated to file "an accurate report" and can be subjected to a cease and desist order if it fails to do so, "regardless of the state of mind of the officers signing the report." The court thus accepted what it viewed as the Comptroller's "novel question of statutory interpretation."

In commenting on whether a cease and desist order may be issued against the bank based on the inaccurate call reports, the court accepted "as reasonable the Comptroller's interpretation of the statute — that the bank, by filing an inaccurate call report, has violated the law."

In August 1990, the Seventh Circuit Court of Appeals, in *Central National Bank of Mattoon v. U.S. Department of Treasury, Office of the Comptroller of the Currency*, upheld the Comptroller's authority to revoke the trust charter of a national bank pursuant to 12 U.S.C. 92a(k). This case represented the first time the Comptroller's authority under section 92a(k) had been challenged. The court ruled unanimously that the Comptroller's choice of remedy may be set aside only if the Comptroller "violated a statute or regulation, made findings of

fact unsupported by substantial evidence or exercised his judgment in an arbitrary which is to say, unreasonable fashion The court recognized that the "choice of sanctions is judgmental — an exercise of administrative discretion entitled to judicial respect, — and depends on particulars of the banking industry to which the generalist federal judiciary is not privy." Noting that the Comptroller had also rejected the administrative law judge's recommended remedy of a cease and desist order, the court concluded that deference is due to the Comptroller, not to the administrative law judge, because the judge's findings are "merely recommendations." The court later denied the bank's request for rehearing

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Larry J. Stein
Litigation Division

Recent Corporate Decisions

On July 10, 1990, the OCC denied a new bank charter application from an organizing group located in Florida. The denial was based on a weak operating plan. The OCC also had concerns about the financial integrity of five of the group's twelve organizers; they had been involved as maker or guarantor of loans that were classified or charged off, or in which foreclosure proceedings had been initiated.

On August 1, 1990, the OCC approved the opening of Treasury Bank, Washington, D.C. The bank, which is owned by the securities firm Babcock & Brown, is not a national bank, but a bank of deposit established pursuant to D.C. Code 26-103(b). OCC approval came only after the bank's board of directors entered into a formal agreement in which it was acknowledged that the bank is subject to OCC jurisdiction and that the bank can neither take any action, nor engage in any activity, impermissible for a national bank without prior OCC approval. Once these conditions were met, the bank's organizers obtained FDIC insurance on August 29, 1990, and the bank was opened for business on August 30, 1990.

On August 9, 1990, the OCC denied a change in bank control notice for a bank in Texas. The OCC had severe supervisory concerns about the bank. Moreover, the purchaser, who was also a director of the bank, proposed to recapitalize the bank through a real estate swap involving property of questionable value. The OCC also concluded that the purchaser did not have the financial capacity to provide the substantial capital injection required. Since the proposed purchaser had been a director of the bank for a substantial period of time, the OCC also believed that the purchaser was to some degree responsible for the bank's unsatisfactory condition and noncompliance with outstanding OCC administrative actions.

This section contains summaries of selected corporate decisions completed during the third quarter of 1990. The cases are provided for informational purposes only. They are noteworthy because they represent issues of importance or unusual methods of accomplishing a particular expansion activity. Copies of the public sections of the applications may be obtained from the Communications Division of the Office of the Comptroller of the Currency (OCC) in Washington, D.C.

On August 10, 1990, the OCC approved an application from Trust Company Bank of South Georgia, N.A., Albany, Georgia, to acquire Albany First Federal Savings and Loan Association by merger. This application represented the first time the office has approved a merger of a national bank and a thrift since enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). The OCC also declared an emergency to allow expedited processing of the application due to the imminent failure of the savings and loan. The Office of Thrift Supervision (OTS) also had approved the proposed merger because the thrift qualified to undertake a voluntary supervisory conversion.

On August 13, 1990, the OCC disapproved a proposed charter application filed by an organizing group located in Connecticut because some of the organizers had been involved in abusive banking practices at other institutions. The OCC took enforcement actions against the institutions and individuals.

On August 15, 1990, the OCC denied a Texas bank's request to establish a de novo branch and to acquire an operating subsidiary that would originate, sell, and service home improvement and health club loans. The OCC found that the bank was without the financial and managerial resources to support the two proposals.

On August 16, 1990, the OCC conditionally approved a request by Citibank, National Association, New York, New York, to establish an operating subsidiary. The operating subsidiary will enter into a partnership with Goldman Sachs for the purpose of extending credit to finance leveraged buyouts and recapitalizations. The OCC conditioned the approval upon compliance by the operating subsidiary of the OCC's lending and investment limitations, the bank having a veto over actions of the partnership, and the partnership being subject to OCC supervision.

On August 16, 1990, the OCC denied a new bank charter application in Florida due to concerns surrounding the integrity and financial difficulties of the proposed chief executive officer and the insufficient credit experience of proposed senior management.

On August 16, 1990, the OCC approved a request submitted by the First National Bank of Huntsville

[illegible] warrants for cash. The funds will be added to the bank's capital surplus account and [illegible]. The warrants, which were accompanied by stock appreciation rights, are redeemable solely at the option of the bank with prior approval by the OCC. The OCC's decision stipulated that redemption would be permitted only if the bank met OCC minimum capital requirements immediately following any such redemption.

On August 27, 1990, the OCC approved Nordstrom, Inc.'s application to establish a credit card bank under the Competitive Equality Banking Act of 1987 (CEBA). According to the proposed operating plan, the bank's activities will be limited to servicing credit card receivables. Immediately after the receivables are purchased from affiliated retail outlets, they will be sold in the secondary market with the bank retaining the servicing rights. The bank will be known as Nordstrom National Credit Bank and will be located in Englewood, Colorado.

On August 30, 1990, the OCC disapproved a proposed new bank in Arkansas due to serious deficiencies in the group's proposed operating plan and other concerns caused by the organizers' association with, and apparent reliance on, a poorly performing new bank also located in the state.

On September 10, 1990, the OCC approved a CEBA credit card bank application submitted by Circuit City, the retail electronics outlet company. The bank will be known as First North American National Bank and will be located in Marietta, Georgia.

On September 13, 1990, the OCC approved the 59th Street Bank, National Association, New York, New York, a new bank charter application received from Banco de Venezuela ("Banco"), a privately owned bank. The bank is to serve the banking needs of Venezuelan nationals. 59th Street Bank will be owned by a U.S. bank holding company, which in turn will be owned by an holding company located in the Channel Islands. The Channel Islands bank holding company will be owned by a trust set up for the benefit of the shareholders of Banco. The U.S. bank holding company will be capitalized at $25 million with $10 million to be downstreamed to 59th Street Bank.

In an effort to reduce holding company borrowings and to simultaneously increase capital at Midlantic National Bank/North, West Paterson, New Jersey (Midlantic National), Midlantic Corporation filed a notice of intent with the OCC in which it proposed to transfer ownership of an existing operating subsidiary to Midlantic National. The operating subsidiary engaged in a variety of factoring activities that had been previously approved by the OCC. However, this office also consulted with the Federal Reserve Board, which concluded that the transaction was a "covered transaction" under section 23A of the Federal Reserve Act since the bank would be indirectly assuming holding company debt that was on the books of the subsidiary. Midlantic National amended its notice, proposing to transfer the subsidiary's debt to the holding company prior to the transfer of the subsidiary to the bank. The amended proposal satisfied the Federal Reserve and OCC. On September 28, 1990, the OCC conditionally approved the transaction as long as the subsidiary is recorded on the bank's books at fair market value and the bank does not acquire any assets, accounts, or credit facilities that were delinquent in excess of 30 days or criticized by federal regulators or the bank's internal loan review.

On September 28, 1990, the OCC approved applications from Key Bank of Eastern New York, N.A., Albany, Key Bank of Central New York, N.A., Syracuse, New York, and Key Bank of Western New York, N.A., Buffalo, New York, to acquire 40 branches, including $2.2 billion in deposits, of Empire Federal Savings Bank, Buffalo, New York. The OCC conditioned its approval on Key Bank East and Key Bank West achieving specific equity capital ratios within a specified period of time.

Corporate Decisions Related to the Community Reinvestment Act*

On August 3, 1990, the OCC conditionally approved a branch and a CBCT application submitted by First Interstate Bank of Texas, National Association, Houston, Texas. The applicant's Community Reinvestment Act (CRA) performance was considered less than satisfactory in determining community credit needs and marketing, in the types of credit offered and extended, and in monitoring and analyzing the geographic distribution of credit provided by the bank. Although an action plan implemented by the bank to correct deficiencies was found to be comprehensive and adequate in scope, satisfying the requirements of CRA had not been demonstrated. The preliminary approval required the bank to demonstrate its performance under CRA prior to opening either deposit facility.

This section is provided pursuant to OCC's Banking Circular 238 dated June 15, 1989. It includes summaries to provide easier access to the OCC's decisions relating to national bank corporate applications that have been conditionally approved or denied on grounds related to CRA. The decision letters are published monthly in a document entitled Interpretations, which is available upon request from the Communications Division.

On August 10, 1990, the OCC conditionally approved applications by Security National Bank of Omaha, Omaha, Nebraska, to establish three CBCT branches. Examination results indicated that the bank's CRA record was less than satisfactory in determining community credit needs and marketing, types of credit offered and extended, geographic distribution of credit, and community development. Hence the applications were approved only after the bank executed a formal agreement with the OCC to address CRA in addition to other laws and regulations prior to opening any of the CBCT branches.

Cross-county Applications
(as of September 30, 1990)

State	Received	Approved	Denied	Pending
Alabama	1	1	0	0
Colorado	4	0	0	4
Florida	13	13	0	0
Georgia	1	0	1	0
Iowa	1	0	0	1
Indiana	2	1	0	1
Kansas	6	5	1	0
Louisiana	22	22	0	0
Mississippi	2	2	0	0
Missouri	2	2	0	0
New Mexico	1	0	0	1
Tennessee	20	20	0	0
Texas	6	6	0	0
Wisconsin	3	3	0	0
TOTAL	84	75	2	7

Note: These figures refer to cross-county branch applications filed with the OCC as a result of OCC's decision on July 9, 1985 to allow Deposit Guaranty National Bank, Jackson, Mississippi, to branch to the same extent as state-chartered thrifts.

Ballard C. Gilmore
Corporate Activity Division

Speeches and Congressional Testimony

Statement of Robert L. Clarke before the Senate Committee on Banking, Housing and Urban Affairs, on modernization of the regulation of financial services, Washington, D.C., July 31, 1990

Introduction

Mr. Chairman and members of the committee, I am here today to discuss the need to modernize the structure and regulation of financial services in the United States.

In your letter of invitation, you asked about my thoughts on reforming the deposit insurance system. The Office of the Comptroller of the Currency (OCC) is participating in a comprehensive interagency study of the deposit insurance system that is being conducted by the Department of the Treasury pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). Since that study is still in progress, I will not make any specific recommendations regarding deposit insurance. I look forward to the opportunity to discuss the study's findings once the work is completed.

As Treasury Secretary Nicholas F. Brady testified last week, financial services activities must be considered in the context of deposit insurance. The Treasury Department deposit insurance study will address this issue in detail. I do, however, have some general comments at this time.

My testimony today will discuss some of the restrictions imposed by federal law on competitive opportunities for banks, the benefits to be gained from a more integrated banking system, and supervisory and risk management techniques that could be used in a more competitive banking environment.

Stated very simply, the present structure unnecessarily restricts the operating authority and the geographical scope of operations of U.S. commercial banks. These restrictions stand in sharp contrast to the continued progress toward financial market liberalization in Europe. They need to be changed. And they need to be changed promptly.

If the U.S. banking system is to remain competitive in international markets and to provide effective support to U.S. industry, it is essential that banks not be encumbered with costly restrictions on their activities that are not needed to ensure the safety and soundness of the banking system or to protect bank customers. I am particularly concerned that some of our laws unnecessarily impair the efficiency of capital markets and thereby raise the cost of capital for U.S. banks. Consequently, U.S. banks are put at a significant disadvantage in rapidly developing international markets and are discouraged from making the investments necessary to compete effectively for business overseas. By reducing the global competitiveness of U.S. financial institutions, vital support for the development of U.S. industry around the world could be reduced, and, domestically, less competition could reduce the variety of services available to consumers and increase their cost.

The OCC supports initiatives to increase capital market efficiency by authorizing U.S. banking firms to offer a broader range of financial services and by removing barriers to interstate banking. Some have argued that expanded competitive opportunities would threaten the safety of the banking system and the solvency of the federal deposit insurance fund. This assumes that such activities would be funded with federally insured deposits or have access to the Federal Reserve System's discount window, and that they would be mismanaged or be inherently riskier than activities which have traditionally been conducted by banks. In my opinion, a less restrictive and more competitive system can be structured in a way that requires equity and debt holders, rather than depositors or taxpayers, to bear whatever risks are associated with the new activities, including the risk of mismanagement — a risk that is a possibility in any business enterprise.

For the part of a bank that continues to be protected by the federal safety net (deposit insurance or the Federal Reserve discount window), I am confident that bank supervisors have the tools to deal with bankers who take inappropriate risks with insured deposits. We do this principally by making sure that banks have enough of their shareholders' own equity capital at risk, by providing effective, ongoing supervision; and by closing institutions when they become insolvent. We are constantly working to improve these supervisory techniques, and other techniques may be suggested by the Treasury study of deposit insurance that I mentioned a moment ago.

Restrictions on Products

Many of the laws that shape our current financial system date back more than 50 years to a period in which the market for financial services was highly seg

[illegible] financial institutions — commercial banks, investment banks, thrift institutions, and insurance companies — were tightly differentiated in terms of the services that they offered to the public and the types of investments that they made. Indeed, some of the restrictions and prohibitions on national bank activities originated in the National Bank Act, which became law in 1864.

Over the years, the lines separating different segments of the market have become increasingly blurred.

- Commercial banks face increased competition for household savings from a host of other providers, such as savings and loan associations, credit unions, and money market mutual funds.

- Savings and loan associations compete with commercial banks, mortgage brokers, insurance companies, and other financial institutions for mortgage originations. The entry of nontraditional lenders into housing finance has been facilitated by the development of a smoothly functioning secondary market for residential mortgages, and by the creation of mortgage-backed securities, which enhance the liquidity of the secondary market.

- The nature of commercial lending has changed. Many major institutional lenders, including some commercial banks, have converted loans into securities, and securities firms are increasingly active in providing bridge loans to underwriting clients — the equivalent of short-term commercial bank financing.

- The growth of the commercial paper market has enabled investment banks to provide credit to the corporate sector, a line of business that has been the traditional domain of commercial banks. Yet commercial banks are substantially restricted from participating in the commercial paper market.

This explosion of new products, made possible in large part by advances in information processing technology, has increased competition in the market for financial services, but the competitive opportunities have not been evenly distributed. While investment banks and other financial institutions have been able to make substantial inroads into many traditional banking services, commercial banks have been impeded from entering new markets by federal laws and regulations that restrict the financial products and services they are authorized to provide.

- The Depression era Glass-Steagall Act prohibits commercial banks from underwriting, investing in, or trading for their own account in corporate securities, and from owning equity stakes in commercial firms. It also severely limits the conditions under which banks may be affiliated with firms that engage in these activities. Yet investment banking firms are allowed to own banks and to offer many products and services that compete directly with banks.

- National banking statutes have been interpreted to limit bank insurance underwriting and brokerage activities, yet companies engaged in insurance underwriting can own banks.

- The Bank Holding Company Act effectively prohibits significant ownership of banks by commercial firms, and also generally restricts the insurance activities of bank holding companies conducted through nonbank subsidiaries. Yet commercial firms can own thrift institutions without the same restrictions, and commercial firms can also own banks on a limited basis (so-called "non-banks").

These restrictions are in sharp contrast to the practice in other major industrialized countries, almost all of which permit, for example, a wide range of securities activities either within the bank itself or in a wholly owned subsidiary of the bank. (Only Japan shares our degree of formal separation between commercial and investment banking — because the modern Japanese banking system was modelled directly after our own — and efforts are under way in Japan to remove these restrictions.) Several European countries also authorize banks to engage in insurance underwriting or to have ties to nonfinancial enterprises to a far greater extent than is allowed in the United States.

Restrictions on Geographic Expansion

Federal law also limits the authority of banks to expand geographically. Under the McFadden Act, national banks (with the approval of the Comptroller) may branch within a state only to the extent permitted to state banks in that state. National banks generally cannot branch across state lines; consequently, interstate banking rules require establishing separate banks in each state, with separate capital structures and management. And the Douglas amendment to the Bank Holding Company Act permits bank holding companies to acquire out-of-state banks only if the ac-

quisition is explicitly authorized by the state in which the target of the acquisition is located

Ironically, the McFadden Act, enacted in 1927, was originally intended to *expand* the geographic opportunities of national banks to allow them to compete with the large branch systems permitted under state charters. Authority to branch within the home office city was granted by Congress in 1927, following a Supreme Court decision upholding the prevailing view that national banks did not have the legal authority to branch. Authority for wider area branching (to the extent permissible for state banks) was added by the Banking Act of 1933, partly to facilitate the injection of new capital into the many banks that were failing during the depression (a situation that parallels recent state legislation and federal policies liberalizing interstate operations by permitting the acquisition of out-of-state insolvent institutions).

In contrast, the Douglas amendment, like the Bank Holding Company Act to which it was attached, was intended to protect small banks from competition from large — and, generally, out-of-state — financial conglomerates. Senator Paul Douglas represented Illinois, then the largest unit-banking state.

Although their original motivation differed, both laws have had the effect of subjecting national banks to the same geographic limits on multi-office networks as state banks. Such restrictions reduce competition in local markets and make banks more vulnerable to local economic downturns.

As competition for the public's savings from other types of financial institutions has intensified, the disadvantages of such limitations on banking networks have become more apparent. Many states have therefore relaxed their restrictions on intrastate branching and interstate banking. Only two states (Montana and Colorado) still practice unit banking, and the majority now permit full statewide branching. Forty-four states now permit acquisitions by out-of-state banking companies. Some of these states have entered into regional compacts, many of which have provisions that will permit entry from any state on a reciprocal basis after a certain date. Other states permit entry from any state with virtually no restrictions.

While many banking firms have succeeded in building interstate banking networks through acquisitions of out-of-state banks, state and federal laws have prevented them from employing potentially more cost-effective direct branch networks. This prohibition is widely believed to have driven up the cost of banking services and to have imposed artificial impediments to consolidation in the financial services industry.

These geographic restrictions, like the product restrictions discussed above, are in sharp contrast to banking practices overseas. As we debate the merits of allowing banking firms to purchase out-of-state banks, most European countries have already adopted full nationwide branching, and this will be expanded to unrestricted branching throughout the European Community within two and a half years.

Advantages of Financial Integration

Authorizing commercial banks to provide a broader range of financial services over a wider geographic territory would confer a variety of benefits on the consumers of financial services and the broader public.

Increased competition in financial services. Allowing banking firms to engage in securities or insurance activities (and allowing securities or insurance firms to obtain bank charters) would promote more vigorous and effective competition in each segment of the financial services market. Increased competition would benefit consumers (both depositors and borrowers) in several ways:

- By reducing the cost of financial services to consumers, as firms compete for business by lowering prices.
- By giving consumers a wider variety of financial services and instruments from which to choose.
- By inducing firms seeking a share of the market to develop specialized niches, resulting in more individualized service for consumers.

Satisfying customers. A system that enforces a rigid separation between commercial banking and other forms of financial intermediation can make it difficult for banks to retain customers, particularly in a rapidly evolving market in which many types of financial services are available elsewhere.

For example, many firms that once relied on traditional bank loans for their financing now find that they can raise money more cheaply by issuing commercial paper. Since Glass-Steagall Act restrictions limit the authority of banking firms to underwrite corporate securities, banks are unable to compete for these customers and are losing them to securities firms.

A more integrated system would provide greater flexibility for banks to adapt their product mix to the changing needs of their customers. Moreover, the interests of some customers may be best served by a mix of

products that neither banks nor securities firms are currently authorized to offer together.

Product diversification. Financial integration would give banking firms additional opportunities to diversify their portfolios and income sources. Diversification into a broader range of financial products and services would enable a bank to achieve a target rate of return with more stable earnings and less risk of losses to uninsured depositors, investors, and the federal deposit insurer.

A more diversified bank would not *necessarily* take fewer risks. An apt analogy would be automobile drivers who benefit from technology that improves gas mileage. Most drivers would elect to save money on gasoline, but some would also choose to take advantage of the lower cost of gasoline to own higher performance cars, since better gas mileage would make high-performance cars less expensive to operate. A few drivers might ultimately spend more on gasoline than before, but they would still have benefitted from the new technology: they would simply have chosen to take the improvement in performance rather than in dollars.

Similarly, while banks could use diversification to reduce portfolio risk, they could also take advantage of diversification to increase the rate of return on bank assets, since diversification reduces the risk penalty of pursuing higher returns. Some banks might end up with the same or even more portfolio risk than before, but their creditors and investors would still be better off, since they would be adequately compensated for the additional risk that the bank assumed on their behalf.

It is important to keep in mind, in this connection, that activities are not unsuitable for banks simply because they are risky. A large part of the economic value created by financial intermediaries such as commercial banks lies in their ability to assess and assume risk and, by pooling funds and diversifying investments, to bear that risk more cheaply than an individual investor could. The safety and soundness of the banking system is not threatened by these activities, as long as the risks assumed by banks are understood by bank managers, are diversified and hedged against to the extent possible, are adequately compensated, and are borne by creditors and equity investors rather than by the FDIC.

Geographic diversification. Broader branching and interstate banking authority would also increase opportunities for diversification. Geographic diversification, like product diversification, can improve the bank's risk/return tradeoff and lower its cost of capital.

These advantages are not merely theoretical. Where interstate banking has been authorized, it has enabled banks to become less dependent on local sources of deposits and less vulnerable to local economic conditions. For example, in Arizona, which has allowed interstate banking since 1986, a large number of national banks are now owned by out-of-state bank holding companies. When the Arizona banking market deteriorated in the late 1980s, some of these parent firms injected badly needed capital into their Arizona operations. As a result, banks doing business in Arizona have probably suffered less from the downturn in the Arizona real estate market than if those banks did not have access to more diversified parent banking firms.

International competitiveness. To the extent that a more fully diversified bank is able to provide a better risk/return tradeoff, the bank should be able to raise capital more cheaply. Conversely, if investors perceive that Glass-Steagall Act and other restrictions prevent U.S. banks from diversifying more fully, and if investors conclude that U.S. banks are, as a consequence, more risky than they would otherwise be, the result would be to drive up the cost of capital faced by U.S. banking firms, placing them at a competitive disadvantage relative to more highly integrated foreign banks. This may provide a partial explanation for the limited success of many U.S. banks in overseas markets, and also for their loss of domestic market share to foreign competitors.

The Glass-Steagall Act also has a direct effect on the ability of U.S. banking firms to compete in overseas markets. Although the European Community may permit U.S. banks to underwrite securities in the post-1992 single European market, the Glass-Steagall Act will prevent U.S. banks from marketing those securities to their customers in the United States. European banks will be under no such restrictions in distributing securities to their customer base in Europe. The absence of a strong home-country distribution system will place U.S. banks at a disadvantage in competing for a share of the European securities market.

The Federal Reserve Board's Regulation K, which implements the International Banking Act of 1978, governs the overseas activities of U.S. banking firms. Regulation K limits the ability of U.S. banks to compete in overseas securities markets by restricting the size of the offerings they can underwrite. These restrictions prevent U.S. banks from participating in some transactions that are open to their European counterparts. We welcome the Federal Reserve Board's recent proposal to ease Regulation K's restrictions, and we will study the proposal carefully.

Reduced operating costs. While Federal Reserve Board orders and court decisions interpreting the Glass-Steagall Act have expanded the securities activities of banking firms in recent years, the Board has required that new securities activities be insulated from commercial banking activities by a series of "firewalls." Safeguards such as these are intended to protect the bank and the deposit insurer, but if the safeguards are more extensive than is necessary, they can inhibit cost-effective integration of the new business activities into banking firms.

Adopting a more integrated structure would permit banking firms to consolidate corporate structures, eliminating horizontal duplication of personnel and overhead costs; to use bank premises, data processing systems, mailings, and other noninterest expenses more cost-effectively; and to achieve greater economies in the joint advertising and marketing of different types of financial services.

Some of these cost savings would be passed on to consumers in the form of lower prices for banking services, and some would be retained in the form of higher bank profits. Banks that are more profitable have greater stability and strength and are better able to attract capital because they can offer more attractive returns.

Financial integration might also permit some consolidation and streamlining of the operations of the various U.S. financial regulatory agencies. Any such consolidation, in addition to reducing government expenditures, would tend to reduce the cost to banks of complying with government regulation. Sources of compliance savings could include a reduction in the number of written regulations with which banks must familiarize themselves, consolidation of reporting requirements, and consolidated and more cost-effective examinations.

Capital market efficiency. Restrictions on banking powers can impede the flow of deposits to the investments that represent their most productive use. Or, the deposits may end up being used for the optimal investments, but the process of financial intermediation may be more costly than is necessary. In either case, the social gains from financial intermediation are less than they would be in a more fully integrated financial system. Similarly, geographic restrictions on branching impede the flow of excess deposits from some regions of the country to other regions of the country where loan demand exceeds locally generated deposits.

The Bank Holding Company Act's prohibitions on the ownership of banks by commercial firms may also reduce capital market efficiency and have the unintended effect of cutting banks off from an important source of capital and depriving the banking system of an additional source of stability. When banks have liquidity problems, they currently must resort to measures such as seeking above-market rate deposits or borrowing from the discount window.

Parent commercial firms could be a source of liquidity for a bank, as they have been recently for securities firms that are owned by financial conglomerates, but few commercial firms would be willing to subject their entire enterprise to extensive regulatory oversight and to the limits that the Bank Holding Company Act places on business activities just so they could buy a bank. Thus, Sears, Roebuck and Company is able to own a thrift because only the thrift, and not the parent company, is subject to regulation by the Office of Thrift Supervision. Sears would undoubtedly have balked at buying a bank, since it would then have been required to divest itself of its retailing business in order to comply with the limitations on permissible activities contained in the Bank Holding Company Act. Yet, in its ownership of Sears Savings Bank, Sears has been a source of capital and stable management.

Risks Posed by Expanded Powers

While financial integration has the potential to improve the operating efficiency of banks, and of capital markets generally, it is appropriate to identify the associated risks and to provide a structure of supervision and regulation that deals appropriately with any such risks.

Such a structure should prevent the safety net provided by federal deposit insurance from being extended to nonbanking activities, both because such an extension could eventually impose large costs on taxpayers, and because there is no valid public policy reason to extend the safety net beyond core banking functions. It should also control the opportunities for conflicts of interest that can arise when a highly integrated financial services firm becomes involved in more than one aspect of the same transaction. Finally, it should ensure that competition in banking and other markets is not compromised by excessive concentration of economic power in a few large financial services conglomerates.

The Magnitude of Risk

Some have argued that expanded competitive opportunities for banks would introduce more risk into the banking system than exists under the present structure. Careful analysis suggests that this is not necessarily the case.

The primary new activities that are being considered for national banks — such as securities dealing and underwriting, insurance brokerage and underwriting, or other agency activities — involve some risks, as do most business ventures, but they are not intrinsically high-risk enterprises. Well-managed firms in each of these areas have remained in business for many years, successfully managing their business risks and delivering profits to their investors. There is no reason why these activities should suddenly become riskier because they are conducted under the auspices of a banking firm. As long as the safety net is not extended to them, there is no reason why they should threaten the safety and soundness of the banking system.

Securities underwriting, to take one example, is not necessarily as risky as businesses in which banks now engage, such as commercial lending. Securities underwriters typically serve as middlemen; their funds are not usually committed to an underwriting transaction unless an underwriting syndicate exists to purchase the securities, and the underwriter is exposed only in the event that the syndicate fails to perform. An underwriter typically is exposed for only a short period of time, if at all. In contrast, a commercial lender typically commits to provide funds for a longer term, thus bearing credit risk over a longer period of time, during which the fortunes of the borrower may change. Commercial lending can, therefore, involve greater risk to a bank than would the same extension of credit structured as an underwriting transaction.

Protecting Safety and Soundness

If, on the other hand, banks were permitted to fund certain expanded powers with insured deposits, thereby extending the safety net to these activities, substantial amounts of risk could be shifted to the federal deposit insurer, and, potentially, to taxpayers.

Not all expanded operating authorities raise this possibility. Brokerage of insurance, for example, as well as some other currently prohibited activities such as management of mutual funds composed of equity securities, involve the bank as an agent rather than as an owner, underwriter, or guarantor of assets. Since the customer, rather than the bank, bears the risk of any change in the assets' value, these activities pose relatively little risk to the bank. They can therefore be conducted in commercial banks without posing any threat to safety and soundness.

Other expanded powers could, however, pose more significant risks. One such example is casualty insurance underwriting. Under normal circumstances, the laws of probability ensure that only a small fraction of policies will generate claims, but for certain types of casualty insurance, a natural disaster could result in large claims by many or all of the underwriter's policyholders. If a bank became a large underwriter, the losses resulting from such an event could, unless the transactions were structured appropriately, be large enough to affect the capital of the bank or cause the bank to fail.

Insurance companies ordinarily protect themselves against large casualty losses by diversifying their underwriting portfolios, pooling risks with other underwriters, and purchasing private reinsurance. The ability to fund this activity with federally insured deposits would shift part of the underwriting risk to the FDIC and diminish a bank's incentive to make such prudent arrangements for risk-spreading.

Yet not all types of insurance would pose significant underwriting risks. Many insurance products are quite similar to bank products; for example, there are few differences between financial guarantee insurance and standby letters of credit. Other forms of insurance, such as life insurance, historically have had predictable loss rates. Insurance activities such as these could safely be conducted in commercial banks or their subsidiaries.

Conflicts of Interest

Combining a broad set of powers in a single financial institution could expand opportunities for practices that enrich some of the institution's customers — or the institution itself — at the expense of other customers. While this is a legitimate concern, I believe that current law provides sufficient controls to manage conflicts of interest that could arise from expanded powers.

Securities activities conducted in a bank subsidiary or holding company affiliate would be subject to the registration and disclosure requirements of the Securities Act of 1933 and the Securities Exchange Act of 1934 (which were enacted at about the same time as the Glass-Steagall Act). These requirements provide substantial safeguards against abuses in securities transactions. Additional protection is provided by the antifraud provisions of the 1933 and 1934 Acts, by the laws governing breaches of fiduciary responsibility, and by the ability of parties injured by abusive securities practices to seek redress through civil proceedings.

In addition, the Federal Reserve Board has required bank holding companies to comply with firewalls designed to control conflicts of interest that might arise from their securities activities. In some instances, however, there may be alternatives to the Board's firewalls that could provide sufficient protection more cheaply.

For example, one of the Board's firewalls prohibits banks from marketing the products of their securities affiliates. A prohibition on marketing may be unnecessary, as long as the relationship between the firms and the risk characteristics of the products are adequately disclosed to the bank's customers.

Market Concentration

It is sometimes claimed that expanded powers would enable a few giant financial services conglomerates to take over the market. In my opinion, the opposite result is more likely, since authorizing banking firms to deal in securities and most forms of insurance (and allowing investment banking and insurance firms to obtain bank charters) would increase the number of firms competing in each segment of the market for financial services.

Economies of scale. Competition could suffer if there were substantial economies of scale in the production of financial services, but most studies of the financial services industry indicate that the minimum efficient scale is small relative to the size of existing firms. What is more to the point, if there were large economies of scale in banking, they would already have enabled large banks to drive their smaller competitors out of business. The high degree of competition that we actually see in the banking market, with numerous small banks coexisting with much larger institutions, indicates that the market is naturally competitive. The combination of commercial and investment banking (or any other combination of currently separated powers) in a single firm should not give large banks any new advantage in competing with smaller firms. Thus, while we can expect current trends in the consolidation of the banking market to continue, and perhaps even to accelerate as a consequence of greater competition resulting from financial integration, there is very little risk that expanded powers would enable a small number of firms to dominate the market.

Finally, if the unexpected occurred and integrated firms were able to exercise excessive market power, antitrust laws should be adequate to handle any problems that arise.

Competitive advantage. It is also sometimes claimed that implicit subsidies in the pricing of such safety net services as federal deposit insurance and access to the discount window would give integrated banking firms an unfair competitive advantage that would enable them to drive other providers of financial services out of business. Such an outcome appears highly unlikely, for two reasons.

First, the general trend in recent years has been to eliminate subsidies from the pricing of safety net services

- The Financial Institutions Reform, Recovery and Enforcement Act raised deposit insurance premiums, and required that premiums be set in the future at levels that would maintain the fund's reserve ratio (the ratio of the fund balance to insured deposits), which implies unsubsidized pricing of deposit insurance.

- The Federal Reserve Board has been moving in the direction of pricing Fed Wire services — including daylight overdrafts — at full cost.

- Last-resort lending is generally unsubsidized, to the extent that the Federal Reserve Board has a policy of making discount window loans at interest rates that exceed the borrower's alternative cost of funds.

Second, even if some implicit subsidies were retained, they would not be likely to enable commercial banks to drive other financial services firms out of the market. While some aspects of bank regulation may benefit banks, other aspects of regulation (such as the cost of supervision and reserve requirements) place them at a relative disadvantage. There is no evidence that the net effect of bank regulation is to give commercial banks a competitive advantage over other financial institutions in markets where they both compete.

Managing the Risks of Expanded Powers

The principal risk that must be addressed by policymakers is the risk to the solvency of individual banks, to taxpayers, who ultimately stand behind the deposit insurance system; and to the stability of the banking system as a whole. Concerns about excessive market concentration resulting from expanded powers do not appear warranted, while the potential for conflicts of interest is adequately controlled by existing statutory and regulatory safeguards.

It is not necessary to forego the stabilizing effect that broad-based deposit insurance has had on the banking system in order to enjoy the benefits of financial integration. Insured deposits can be insulated from risk by requiring that certain types of newly permitted business activities be conducted in separately incorporated affiliates funded with uninsured liabilities and externally generated capital.

Insulating banks from risk is not the only reason to require banking companies to conduct certain ac

[illegible] Separation would also ensure that [illegible] participation in the pricing of federal safety net services will not give banking firms an unfair competitive advantage in nonbanking markets — although, as noted previously, such anticompetitive effects would not be expected to be large in any event.

Furthermore, separation would ensure that the safety net was not inappropriately extended to activities for which it was not intended. The purpose of the safety net is closely linked to the special role that certain core banking functions (deposit-taking, operating the payments system, and maintaining reserves that are used to manage the money supply) play in the economy. There may be reasons — quite apart from the risk, cost, or effect on competition of doing so — to avoid extending the safety net to other activities that do not share these special characteristics.

Finally, separation would provide clear lines of demarcation between the areas of responsibility of federal financial regulatory agencies, such as the division of responsibilities between banking agencies and the Securities and Exchange Commission. This would facilitate functional regulation of financial markets, where appropriate.

Corporate Separateness and Firewalls

In a series of decisions issued since 1987 interpreting section 20 of the Glass-Steagall Act, the Board of Governors of the Federal Reserve System has approved applications from bank holding companies to establish non-bank subsidiaries that underwrite and deal to a limited extent in certain bank-ineligible securities. To comply with the restriction of section 20 that prevents banks from being affiliated with firms that are "engaged principally" in underwriting, the Board prohibits such affiliations if the revenues generated by "bank-ineligible" activities exceed a set percentage of the revenues of the section 20 affiliate. The Board broadened the range of permissible activities in 1989 to include all corporate debt securities, with deferred authority to underwrite equity as well.

In its section 20 orders, the Board imposed a number of firewalls intended to insulate banks from risk. These firewalls generally prohibit banks from extending credit to, selling assets to, purchasing assets from, or financing the purchase by third parties of securities underwritten by their section 20 affiliates during the underwriting period and for a period of time thereafter, and the Board requires that any investment by a bank holding company in its section 20 affiliate must be deducted from the holding company's regulatory capital.

These firewalls can be criticized for subjecting affiliated firms engaging in expanded powers to a more stringent standard than is applied to extensions of credit to unrelated firms, which may involve comparable risk. Bank regulators recognize that individual risky loans are not necessarily unsuitable for bank investment, providing the bank can achieve a sufficient degree of diversification. Consequently, rather than prohibiting all risky loans, regulators have traditionally set limits on the fraction of a bank's portfolio that may consist of loans to any one borrower.

The same approach could be applied to expanded powers. Instead of prohibiting a bank from lending to or investing in its expanded powers affiliates, the aggregate exposure of a bank to its affiliate — including "arms-length" extensions of credit to the affiliate and its customers, purchases of assets other than short-term government securities, and equity holdings in the affiliate — could be subject to limitations analogous to the current limits on loans to one borrower.

Because equity claims are subordinate to debt and therefore expose the bank to more risk, it might be appropriate to count equity holdings more heavily than lending in the exposure limits. For example, if the exposure limit were set at 10 percent of capital, and if equity were counted twice as heavily as lending, then a bank with capitalization of $1 billion could lend up to $100 million to its securities affiliate, or it could own up to $50 million of the equity of its affiliate, but not both. Or, it could have a mixture of debt and equity exposure to the affiliate that satisfied the limit, such as $80 million in lending and $10 million in equity.

The most appropriate approach to bank supervision under a revised system of bank powers would vary depending on the exact nature of the revised system. Generally, a banking structure based on exposure limits would not place any extraordinary demands on the supervisory functions of bank regulatory agencies. Limits on the aggregate credit exposures of banks to their expanded powers affiliates would have to be monitored and enforced, but this would not present unusual problems to supervisors already accustomed to enforcing limits on loans to one borrower or to related borrowers.

Using exposure limits to control interaffiliate transactions would provide the maximum benefits from financial integration consistent with safety and soundness of the banking system. Corporate separateness would ensure that a bank could lose no more than its book investment in its affiliate. Limits on exposure, properly set, would ensure that even the loss of that entire investment could not endanger the safety and soundness of the bank.

Corporate Structure

In order to protect the bank from risks associated with new powers and to limit the extension of the federal safety net, the corporate structure of the banking firm must insulate the bank from certain expanded powers. This insulation could be achieved through separately capitalized subsidiaries of the bank or through subsidiaries of a bank holding company. Any necessary firewalls could be applied to either type of subsidiary. For example, the OCC sometimes imposes supervisory conditions on the approval of new activities to be carried out in operating subsidiaries of national banks, including application of the legal lending limit. As long as the corporate structure provided appropriate protection to bank safety and soundness, the choice could be left to the banking firm.

Bank Supervision

In order for the U.S. banking system to be safe, sound, and competitive, we must have well-diversified and profitable institutions and effective supervision to protect the system against excessive risk. Before speaking to the question of how expanded powers can be supervised, I think it is worth digressing for a moment to discuss how we supervise current banking activities.

We use three basic tools for controlling risk: capital standards, supervision and examination, and bank closure. In recent years, the OCC has made important improvements in all three areas.

Capital Standards

At the end of this year, the OCC, along with the Federal Reserve Board and the FDIC, will begin to implement risk-based capital standards. This will make banks more sensitive to the credit risks in their portfolios and to their off-balance sheet risks. It will also force them to give greater emphasis to equity capital. As a result, many of the largest banks will either have to raise more capital or reduce their balance sheet risk.

As we phase in these requirements, we are working to improve them further. As I have said to this committee in the past, the eight percent minimum risk-based capital standard represents only a minimum standard; where appropriate, the OCC will require banks to have more capital than the minimum — as many banks already do today. Representatives from the OCC and the Federal Reserve System are now participating in working groups set up by the Bank for International Settlements in Basle, Switzerland to determine if interest rate risk and foreign exchange rate risk can be reflected in the risk-based capital guidelines. Once we have evaluated these risks — and considered other enhancements to risk-based capital requirements that we are exploring on our own — we will have a more accurate assessment of what the precise level of bank capital ultimately should be. But one thing is clear: we need to ensure that significant losses from bank failures are borne by equity and uninsured debt holders, not the FDIC. It is equally clear that we must avoid placing U.S. banks in a position that prevents them from being competitive with other financial services providers, domestic and foreign.

Supervision and Examination

Strong capital standards must be complemented by a strong supervisory system. One of the lessons of the savings and loan crisis is that the assets of depository institutions must be valued realistically. Looking the other way only leads to problems later on. Effective bank supervision serves as a check to ensure that asset valuations are in fact realistic.

Supervision involves a great deal of judgment, and devising objective measures of its effectiveness is difficult at best. Some observers of the industry try to measure the quality of bank supervision by the frequency with which examiners perform complete examinations at each bank. This has the effect of forcing supervisors to spend too much time on areas that do not represent significant threats to the safety and soundness of the banking system.

An efficient allocation of available examination resources is essential if the OCC is to fulfill its responsibilities as the primary supervisor for more than 4,100 national banks, including most of the nation's largest commercial banks. The OCC allocates examining resources based on an annual strategy established for each institution. These strategies are based on our evaluations of the level of risk that we see in each bank, and the level of risk that it presents to the national banking system as a whole.

Large national banks account for roughly 48 percent of total national bank assets and 29 percent of all assets in the banking system. They are complex institutions that play a crucial role in the nation's financial system. Because of their size and complexity, we maintain a full-time resident examination team in each multinational bank to devise and carry out examination strategies.

The examining strategies for other banks are determined case-by-case, with the greatest resources focused on those banks where we see indications of potential problems. Our approach is not unlike that of the Internal Revenue Service, which directs more of its

[illegible] resources at [illegible] with [illegible] higher risk categories.

Another important aspect of effective bank supervision is trying to anticipate systemic credit problems. As an example, in 1988 the OCC spearheaded the efforts of the federal bank regulators to review loans involving highly leveraged transactions. Also, beginning in 1988, in response to a steady increase in the real estate loan portfolios of national banks, we began to warn bankers that local real estate markets in certain parts of the country were being overbuilt. For example, an OCC Advisory sent to the chief executive officers of all national banks in December of 1988 encouraged them to review their real estate lending policies and practices in light of softening real estate markets, and warned that high profits earned while the local economy was still growing could mask serious problems with the quality of internal underwriting controls. Unfortunately, our warnings about the softening real estate markets have come true in many parts of the country. And over the past year, our reviews of the real estate portfolios of a number of national banks have verified asset quality problems and weaknesses in management controls.

We have heard criticism that the OCC is overreacting, but such comments resemble those made in the mid-1980s, when businessmen and public figures swept aside concerns about the commercial real estate portfolios of savings and loan institutions. One of my greatest frustrations as Comptroller is that I have been warning about real estate problems for several years, and now some people ask me why we did not warn them sooner.

At the same time, bankers should not respond to our warnings by cutting off credit to qualified borrowers. The OCC, working with officials from other bank regulatory agencies, has been taking constructive steps to deal with possible overreaction to market conditions and regulatory scrutiny. On May 10, Federal Reserve Board Chairman Alan Greenspan, FDIC Chairman L. William Seidman, and I met with officials of the American Bankers Association to allay fears among bankers that regulators would criticize prudent bank lending. In that meeting, we stressed that our actions were not meant to discourage banks from lending to creditworthy borrowers. All of us expressed our belief that banks should continue to lend, that qualified borrowers do exist and that they represent important business opportunities. This is the message that I have been delivering throughout the country to bankers, businessmen, local leaders, members of Congress, and the press.

Bank Closure

The third and most potent supervisory tool at our disposal is the ability to close an institution when its capital is depleted. Last year, the OCC changed its closure regulation to make it possible to close banks earlier. We no longer include loan loss reserves in measuring a bank's capital solvency. This allows us to close an insolvent bank at the point when its equity capital is exhausted. It will also significantly reduce the cost to the FDIC of resolving bank failures.

Conclusion

The U.S. banking system stands out among major industrialized countries in the degree of separation that it requires between commercial banking and other forms of financial intermediation. Our extensive restrictions on banking powers and on geographic expansion reduce competition in financial markets, make it difficult for banks to adjust to a changing marketplace, reduce their opportunities for diversification, and perpetuate a less efficient system of capital distribution. As a result, U.S. banks are less efficient, face a higher cost of capital, and are weaker competitors than their more highly integrated foreign counterparts.

Restrictions imposed by current banking law and regulations also harm consumers, who have fewer choices in shopping for financial services, and pay more for them; harm businesses that depend on banks for credit, and find their sources of credit shrinking; and harm the economy as a whole, which suffers when the efficiency of capital markets declines.

These restrictions can be relaxed without threatening the safety and soundness of the banking system. Housing expanded powers in separate, incorporated affiliates and limiting transactions between them and their banking affiliates will allow banking companies to enjoy the benefits of financial integration without exposing insured deposits to new risk. Supervising banking companies structured in this way should not pose any new difficulties for bank supervisory agencies.

If we fail to address these critical issues, the United States may find in a few years that it has lost its position as a leader in the global financial system. This argues in favor of a comprehensive reexamination of the statutes responsible for the current fragmented state of our financial services industry.

Statement of Robert L. Clarke before the House Committee on Banking, Finance and Urban Affairs, on restructuring troubled real estate loans, Washington, D.C., August 9, 1990

Mr Chairman and members of the committee, I am here at your request to describe how the Office of the Comptroller of the Currency (OCC) oversees the real estate lending practices of national banks. In addition to the committee's general interest in real estate lending, the committee has raised specific questions about the methods used by banks to restructure troubled real estate loans. The principal reason I am here today is to reassure the committee that troubled loans of all sizes and types are being treated by the OCC in a fair and evenhanded manner, and we expect that banks will deal with such loans in the same way.

The Congress has recognized the need for the OCC to treat the information that it obtains in the examination process as highly confidential. It has been the OCC's long-standing policy not to divulge examination data or other financial information that specifically identifies any individual bank or borrower. I will therefore confine my remarks to the general procedures that the OCC uses in reviewing real estate loan portfolios.

My statement begins with a brief discussion of market developments over the past few years that led to the current weakness in the real estate portfolios of many commercial banks. The principal thrust of my statement is a discussion of the methods used by the OCC to supervise real estate lending.

Developments in Real Estate Markets

While real estate lending has traditionally been more closely associated with savings and loan associations than with commercial banks, banks have for many years been significant sources of residential mortgage loans, as well as the largest source of construction loans for both multifamily residential and nonresidential property. Thus, commercial bank involvement in real estate markets is not a new development.

In recent years, however, banks have turned increasingly to real estate lending as a source of revenue. This is part of a broader trend in banking, stemming from the gradual evolution of traditional banking markets and from restrictive statutes, such as the Glass-Steagall Act, that have made it difficult for commercial banks to retain traditional customers in a changing marketplace.

For example, the rapidly growing market for commercial paper has permitted many middle to large sized corporations, which formerly would have relied on bank loans for their financing needs, to access capital markets directly. Commercial banks, significantly limited in their ability to underwrite corporate securities or otherwise provide the credit enhancements that the market demands, have been unable to compete on equal terms for these customers. Consequently, the customers have, for the most part, left banks for securities firms, which are not so restricted. On the retail side, money market mutual funds have drawn away core deposits, driving up the cost of funding for commercial banks.

Confronted with the erosion of their traditional lines of business, banks have sought to expand other sources of revenue. Real estate lending has been a very attractive source. In the past 10 years, real estate loans outstanding at national banks have more than tripled, from $140 billion in 1980 to $475 billion in the first quarter of 1991. In 1980, real estate loans accounted for less than one quarter of total loans. In the first quarter of 1990, they accounted for more than 37 percent of total loans.

During the past five years, there has also been a shift in the composition of real estate lending. While residential mortgage lending remains the largest portion of real estate lending by commercial banks, construction and development lending has been increasing in volume. Both the increased concentration of real estate lending in their portfolios, and the increased emphasis on more speculative construction and development loans, have made commercial banks more susceptible to downturns in the real estate market.

The Economic Environment

The OCC continually monitors the economic environment for indications of changes that may lead to supervisory problems, and we encourage banks to do the same. In 1987, when we saw indications of softening in some real estate markets outside the Southwest (which had experienced problems earlier), we began to review the real estate lending practices at a number of the banks operating in those markets. We stepped up those efforts in 1988. In that year, OCC examiners in our Southeastern District examined the real estate lending practices at 13 of the regional banks that had the largest exposure to real estate in the district. The examiners subsequently met with the chief executive officers and members of the boards of directors of those banks to discuss the specific findings of the examinations, the softening real estate market, and the need for prudent

real estate lending standards. Our examiners emphasized [illegible] the need for improved lending standards and [illegible] and the potential for losses if current weaknesses were not corrected.

To communicate these concerns more widely to the banking industry, later in 1988 the OCC sent an advisory letter to the chief executive officers of all national banks (numbering about 4,300 at that time), warning about the potential risks of excessive concentration in real estate lending and citing some of the deficiencies which we had discovered in our examinations of regional banks. The message we delivered was that real estate lending itself does not entail undue risk. However, if proper underwriting standards are not employed, if sufficient control mechanisms are not put in place to allow management to understand levels of risk, or if data supplied to management are incomplete or outdated, then there is the potential for substantial risk.

In 1989, softening regional economies, coupled with indications of overbuilding in many cities, led to increased concern about the quality of real estate loans. Beginning in the spring of 1989 and continuing into 1990, our examiners have conducted comprehensive examinations of the real estate portfolios of a number of national banks. The increases in loan loss reserves that resulted from these examinations, and their effects on bank profits and bank stock prices, have been widely reported in the national press.

When real estate markets become overbuilt, declining rents or the unavailability of tenants or customers can reduce the creditworthiness of otherwise sound and well-managed projects. Under these circumstances, prudent bankers will choose not to finance some projects that would have received credit in more favorable economic circumstances.

There have been reports that some bankers have reduced their lending to creditworthy customers as well. While this problem does not appear to be widespread, we have taken steps to deal with possible overreaction to market conditions and regulatory scrutiny. At the same time that we are urging banks to recognize existing problems in their portfolios, we are encouraging them to make loans to creditworthy borrowers. I have been delivering this message personally throughout the country to bankers, businessmen, local leaders, members of Congress, and the press, and I believe the message is being heard.

We have also taken steps to ensure that OCC examiners deal with real estate lending problems consistently and evenhandedly. Examiners-in-charge from multinational and large regional banks throughout the country were brought to Washington last week to attend a conference on real estate lending examinations conducted by senior bank supervision managers. The OCC has also produced a videotaped discussion of real estate lending issues which will be shown to OCC examiners and bank managers. Written guidance for examiners on real estate lending, which is now embodied in a number of banking and examining circulars, is being clarified and consolidated in a supplement to the *Comptroller's Handbook for National Bank Examiners*. And, of course, the OCC always encourages any banker who has a question or a complaint about our examinations or our policies to come discuss the matter with us.

OCC Supervision

It is important, given the recent public attention focused on our examinations, to understand the OCC's role in reviewing a bank's loan portfolio. Our job as bank supervisors includes three important tasks. First, we ensure that banks adopt and adhere to sound credit practices. Second, we ensure that their books accurately reflect the value of their assets and liabilities. And third, we ensure that national banks establish management systems that are capable of tracking bank activities and can reasonably anticipate and adjust to changing market conditions.

As part of this process, we expect bankers to have mechanisms in place to conduct their own asset quality reviews. Ideally, an OCC examiner should then only have to check to see that the mechanisms exist and that they are performing as intended. But in a less than perfect world, we often find faults that bankers have not recognized. We then take whatever steps are necessary to make bankers recognize them.

We work to ensure that banks accurately report the condition of their portfolios and maintain reserves that are adequate to protect against anticipated losses. In addition, if loan quality or other problems result in a bank's having inadequate capital, we work with the bank to help it develop and follow a credible capital restoration plan that will get it back to health.

At the same time, supervisors must be willing to close banks that cannot survive in a competitive market. Banks are not public utilities; they are, first and foremost, private businesses. Like other private businesses, some banks will fail. Failures are not necessarily a reflection of the quality of supervision that banks receive. Indeed, if bank supervisors guarantee that even the poorest management will be able to succeed, the banking system will become very inefficient. What we must do is allow banks to fail, but in a manner that ensures that it is the shareholders' money that is at risk.

— not the deposit insurer's or the taxpayers. Bank supervisors achieve that result by enforcing strong capital adequacy standards, and by closing banks when they become insolvent.

Bank Examinations

The supervisory process is complex and requires a great deal of judgment. Not surprisingly, there has been a great deal of confusion and misinformation about the purpose of bank supervision, the methods we employ to determine the need for an examination, the examination process, and the criteria we employ in assessing the quality of a loan portfolio. Consequently, it is important for the committee to understand how we go about our examinations.

The OCC strives to assure that a bank's management has an uderstanding of its institution's condition that is true and reasonable and that management's decisions reflect this true and reasonable understanding. Bank management must be able to support its credit decisions to its board of directors and its shareholders. So we encourage, coax, caution, and — when necessary — compel national bankers to focus on the quality of their investments and to take necessary steps to improve them.

Determining the Need for a Focused Examination

One of the supervisory techniques that we use is the focused examination of credit categories that our routine monitoring of economic trends leads us to believe call for special scrutiny. A focused examination may reflect supervisory concern about deterioration in the credit quality of a particular type of loan, but it does not necessarily reflect such concern. It may be triggered by excessively large concentrations of credit in a single category or unusually rapid growth in one portion of a bank's portfolio, even if there are no signs of weakness in loan performance or credit quality. It indicates only that the OCC wants to ensure that banks apply the same sound credit standards in the targeted category that we expect them to apply to all other loans.

We have conducted several kinds of focused examinations in recent years: on loans financing oil and gas exploration, on loans to lesser developed countries, on loans financing highly leveraged transactions, and on real estate lending in several regions of the country.

The Examination Process

In smaller banks, an examination team — an examiner-in-charge and a small staff — judges the quality of the selected loans. The conclusions reached by the examination team are typically reviewed by other examiners.

In larger banking companies, where there may be several subsidiary banks, and where more than one supervisory agency may be involved in the examination, the procedure becomes more elaborate. A team of examiners is assembled from the staffs of the various participating agencies. The team is placed under the direction of an examiner-in-charge, who is usually from the agency that has supervisory responsibility for the banking firm's principal bank. Each of the banking firm's subsidiaries that is under review is also assigned an examiner to lead that work.

Examiners at a subsidiary discuss all of the loans under their review with bank managers and individual loan officers. The examiner in charge of that subsidiary then reviews the work and, if necessary, discusses it with the examiners in charge of examining other parts of the banking firm. The examiner-in-charge at the entire banking firm reviews the work on the most significant areas and loans. If the examiner-in-charge considers it necessary, the loans become the subject of further discussion among the examiners and with bank managers. During this entire process, bank management has the opportunity to discuss specific loans with the examiners. If bank managers believe that a loan has been classified improperly, they can raise questions at all levels of the review process, and the OCC encourages them to do so.

During this review process, the examiners work with bank managers to ensure that the three goals I mentioned earlier are met: that the bank has adopted and adheres to sound credit practices, that its financial statements accurately reflect the value of its assets and liabilities, and that the bank has established management systems capable of tracking bank activities and reasonably anticipating and adjusting to changing market conditions.

Shared National Credits

Some larger real estate loans — those in which more than one bank participates — go through an additional stage of supervision as part of the Shared National Credit program. A Shared National Credit is any loan of $20 million or more that is shared by two or more federally insured depository institutions. The Shared National Credit examination process began at the OCC in 1975; the Federal Reserve System and the FDIC joined the OCC effort shortly thereafter. The purpose of the Shared National Credit review is to avoid duplicate reviews of the same loan and ensure consistent treatment of all banks participating in the credit.

[illegible] these three agencies perform a joint supervisory review of all loans that qualify as Shared National Credits. Each credit is reviewed at one depository institution, usually the agent bank. During the credit examination, examiners assign each loan to one of five categories: pass, special mention, substandard, doubtful, and loss. This rating is then reported to every depository institution that is participating in that loan, and is used in all subsequent examinations of those institutions.

Assessing the Quality of a Loan Portfolio

If a bank is having problems collecting its loans, or anticipates such problems, then prudent accounting requires some recognition of the potential loss. This is the purpose of loan loss reserves. The bank examination evaluates reserves based upon a review of individual loans and of the overall structure of the bank's balance sheet.

Some observers have asked why banks cannot be allowed to carry troubled loans for a period of time at their book values, rather tan being required to write them down immediately. We much prefer to work with a bank after it has accurately recognized and reported its condition, rather than allowing the bank to sweep problems under the rug. In that manner, an accurate picture of the condition of the bank is presented and appropriate remedial activity can be carried out. The necessity of working out problem loans is a fact of life in banking, as it is in bank supervision. The key in all instances is having a credible work-out plan.

When OCC examiners review a real estate loan — or any other loan that finances income-producing property — they assess whether the projected cash flows from the property and from other sources are sufficient to meet required loan payments. This determination relies largely upon the bank's own estimate of the property's future cash flows. Obviously, to the extent that the current condition of the property does not match the bank's recorded estimates, adjustments must be made. But, for the most part, we do not impose our own view of future economic conditions in projecting potential losses.

For example, if a particular property is leased significantly below expected levels and office occupancy rates have fallen in the market where the property is located, then the estimated projected cash flows must be correspondingly lowered. In making this cash flow projection, OCC examiners typically use the bank's own recorded forecast of the ultimate occupancy rate; but in doing so, they recognize that it will take longer for the property to be leased. Consequently, they require the bank's valuation to reflect that reality.

Classifying loans necessarily involves judgments about which reasonable people may disagree, but this unavoidable "gray area" is not a major source of disagreement between bankers and examiners. There is no disagreement about the vast majority of loans that are being criticized and reserved against. They are simply not paying as the bank expected and, therefore, cannot be recorded as doing so.

In most cases in which additional reserves are required, the loans are not performing as expected. In some cases, the payments may be current, but in criticizing the loan, the examiner is recognizing the reality that the resources are no longer there for the payments to continue to be made.

Consider an example in which a developer has received a loan to construct and lease a new office building. If demand for office space in that market appears insufficient to generate the cash flow needed to service the loan, the examiner may question the underlying quality of the asset. This is true even if the borrower has been able to make interest payments on the loan to keep it current. Investigation will often show that the developer has been keeping the loan current only by borrowing the funds from another credit source, possibly even a loan at the same bank that underwrote the construction loan; or that the developer or its guarantors are relying on cash flow from other projects, which may also be in declining markets, in order to keep the debt current; or that there is no support for the cash flow.

The related topic of guarantors has also been the subject of a great deal of discussion. When a bank makes a construction real estate loan, the usual sources of repayment are the sale of the property or a permanent refinancing. If the primary sources of repayment are not sufficient or are unavailable to meet the obligation, the bank must look to other sources — often the developer or a guarantor — to service all or part of the debt. Prudent banking requires that a bank have all the necessary information to determine the ability of that developer or guarantor to make payments and service the loan. Consequently, it should come as no surprise that examiners will ask for and review information on guarantors. Increased emphasis on the capacity of a guarantor is simple recognition of the changing environment. In a strong economy, where the underlying project has sufficient cash flow to service the debt in accordance with its terms, the financial capacity of the guarantor is less important. However, even when the condition of the guarantor is less important, the bank should still have timely information on the guarantor, and should expect to be criticized by OCC examiners if it did not.

Restructuring Troubled Loans

Some observers have raised questions as to whether large real estate borrowers who have been unable to repay their loans on schedule have been allowed to reschedule their debts on more generous terms than have been available to small borrowers. We do not encourage banks to treat large borrowers any differently than small borrowers.

Whenever a borrower is unable to repay a loan on schedule, the bank faces a straightforward business decision: whether it can recover more of its investment by foreclosing than by rescheduling the loan. The answer — for large or small borrowers — can go either way, depending on the circumstances of the borrower and the value of the assets backing the loan. It is difficult to imagine a well-run bank which has equity funds at stake making the decision on any other basis than to minimize its eventual loss.

Of course, large borrowers may have options that are not ordinarily available to small borrowers. For example, large borrowers often have several independently financed business ventures, only some of which may be financially troubled. They may therefore have uncommitted revenues or collateral from other projects that can be used to obtain additional financing. Small borrowers, in contrast, more frequently have no resources beyond the revenue stream and collateral that was pledged on the original loan.

Because of such differences, a bank may find that a large borrower presents better prospects for recovery through renegotiation than through foreclosure, while the opposite may more frequently be the case for small borrowers. But small borrowers who do have the means of demonstrating their creditworthiness can and frequently do have their loans rescheduled instead of foreclosed. The OCC encourages banks to work out whatever they can with any borrower.

In the final analysis, however, the decision to reschedule a loan is a decision to extend credit, and it rests on the same types of considerations that underlie any extension of credit: the borrower's ability to repay the loan and the value of collateral that the borrower can pledge. The OCC closely supervises the credit policies and practices of national banks, but we do not seek to influence individual rescheduling decisions, for the same reason that we do not dictate any other individual credit decision: we believe that such decisions should be made by bank managers. Our role in the treatment of any individual troubled loan is focused on ensuring that the loan is valued correctly on the bank's balance sheet and that the bank has reserved adequate funds for loan losses. What the bank then does with the loan — whether it reschedules or forecloses — is up to the bank.

Conclusions

The OCC will continue to monitor real estate markets, to conduct focused examinations of real estate portfolios at national banks where we have indications of credit problems, to direct those banks to reserve against loan losses when this is necessary to reflect the actual value of the loans, and to urge banks in weak real estate markets to maintain high underwriting standards. These steps involve a certain amount of pain for those involved, but they are precisely the steps that are required to work out the problems in real estate loan portfolios.

Statement of Robert L. Clarke before the Senate Committee on Banking, Housing and Urban Affairs, on capital standards for national banks, Washington, D.C., September 10, 1990

Mr. Chairman and members of the committee, I am here to discuss the report of the Office of the Comptroller of the Currency (OCC) comparing the capital and accounting standards of the OCC with those of the Office of Thrift Supervision (OTS), the Board of Governors of the Federal Reserve System (FRB), and the Federal Deposit Insurance Corporation (FDIC). The OCC submitted the report on August 10, 1990, pursuant to section 1215 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). As the OCC's report indicates, all of the federal banking agencies have generally similar minimum capital requirements and accounting rules. Except for the differences between bank and thrift capital standards that are required by FIRREA, most of the differences are relatively minor. As to the differences that remain, we are continuing to work with the other agencies to reduce many of them.

Consequently, I will address the additional issues you raised in your invitation letter and discuss the efforts of the OCC to ensure capital adequacy at national banks.

The Role of Capital

It should not be surprising that there are only minor differences in the capital standards of the federal banking supervisory agencies. All the agencies consider it essential that the institutions which they supervise maintain adequate capital. Bank supervisors have been working together since 1986 to modernize capital standards, reflecting our collective belief that capital plays a fundamental role in maintaining the safety and soundness of the banking system. Adequate capital forces market discipline on a bank — putting pressure on bank management to operate efficiently and compete effectively, and decreasing the willingness of the bank to gamble with insured deposits. It also protects an institution from insolvency due to unanticipated losses. This helps to preserve the franchise value of the institution, while minimizing claims against the deposit insurance fund.

Bank supervisors must maintain capital standards that will promote market discipline and provide protection from insolvency, while, at the same time, being sensitive to maintain competitiveness and provide an acceptable return to investors.

Risk-Based Capital Standards

In 1989, the OCC, FRB, and FDIC adopted common risk-based minimum capital standards for insured commercial banks based upon the International Capital Accord developed by the Basle Committee on Banking Supervision. All of the G-10 countries, as well as many additional countries, have adopted the Basle framework. As a result of these standards, at the end of this year, banks will be expected to have total capital equal to at least 7.25 percent of risk-weighted assets. When risk-based capital is fully phased in, at year-end 1992, banks will be required to have total capital equal to at least 8 percent of risk-weighted assets.

As required by FIRREA, in December 1989, the OTS established risk-based capital standards for savings and loans which, while different in some respects, are based upon the same principles underlying the banking agencies' risk-based capital standards.

Risk-based capital is an important improvement over current capital standards. This is reflected in both the definitional improvements in capital requirements and in the indications of its effects. Its improvements include incorporating off-balance sheet activities into the determination of capital minimums, and weighting assets according to broad measures of their credit risk. More importantly, the new standards redefine capital to increase a bank's ability to absorb unanticipated losses. It requires that at least one-half of a bank's regulatory capital consist of core capital (primarily common shareholder's equity, noncumulative perpetual preferred stock, and related surpluses). The remainder of a bank's capital can consist of capital elements such as subordinated debt and cumulative preferred stock which provide additional capital support. The allowance for loan and lease losses (ALLL) — which is designed to account for anticipated losses and thus offers limited capital support — is limited in the determination of regulatory capital to 1.25 percent of risk-weighted assets. In the past, a bank could meet minimum requirements by relying entirely upon the ALLL.

The risk-based capital guidelines will significantly increase the total capital required in the banking system and require the greatest increase at multinational and large regional institutions — the institutions that, because of their size, present the greatest risk to the banking system and to the deposit insurance fund. Based upon March 1990 data, we estimate that

(1) As of March, 1990, over one year after the risk-based capital requirements were finalized, 562 out of 12,414 insured commercial banks that hold 36 percent of all the

assets in the banking system did not meet the requirements and, thus, still needed to make further adjustments in order to comply with the standards by final implementation on December 31, 1992. By comparison, on the same date, only 457 insured commercial banks, accounting for only 3 percent of assets, failed to meet the old capital minimums, which will expire on December 31, 1990.

(2) If the insured commercial banks that do not meet the risk-based capital standards were to make no changes that affect risk-weightings in their portfolios, we estimate that they would need to raise an additional $24 billion in capital to meet the fully phased-in risk-based capital standards.

(3) For all banks to meet the year-end 1992 risk-based capital standards, the system would need to have $217 billion in capital. To meet current standards only $195 billion would be needed. Moreover, as explained earlier, risk-based capital relies much more heavily upon common equity than do current standards.

The Tandem Leverage Ratio Requirement

To supplement the risk-based capital standards, the banking agencies are in various stages of implementing a new minimum ratio of capital to total assets (minimum leverage ratio) that will employ the new definition of total capital. This is a tandem capital requirement that is in addition to the risk-based capital requirements of the international accord. Banks will have to meet both the minimum leverage ratio and the risk-based capital requirements.

As this committee knows, there has been a great deal of discussion about the appropriate leverage ratio requirements. The FRB has issued a final rule which sets a minimum leverage ratio for top rated banks of 3 percent of adjusted total assets. The OCC has also proposed a 3 percent minimum leverage ratio for the best managed banks. The FDIC is in the process of developing its own leverage ratio proposal. All leverage ratios would work in tandem with the risk-based capital requirements. Banks would have to meet both the leverage ratio and the risk-based capital requirement. It is also important to remember that, because of the improved definition of capital under the risk-based capital guidelines — which increases the emphasis on pure equity capital — a lower ratio of capital to assets does not necessarily imply a reduction in real capital levels when compared to the current definitions of capital.

The purpose of the leverage ratio is to ensure that even banks that invest exclusively in low risk weighted assets still have to maintain a certain level of hard capital. It is based on the principle that any bank, no matter how minimal its risk, needs to maintain some level of equity capital to protect against unseen and extraordinary events.

The OCC and the other members of the Basle Committee have all agreed that the risk-based capital standard should be the primary method for determining capital adequacy. To the extent that the leverage requirement overrides risk-based capital as the relevant capital standard at an institution, it undercuts the incentives created by risk-based capital to reduce credit risk. Moreover, because the leverage requirement does not take into account off-balance sheet activities, it encourages a bank to simply move risks off the balance sheet while possibly increasing the actual risk at the institution. In fact, an institution using this strategy might be able to meet a higher leverage requirement without any increase in capital or reduction in risk — just by exchanging on-balance sheet risks for off-balance sheet risks. The risk-based capital system was designed to help address this situation. Setting the minimum leverage ratio too high would destroy the risk reduction incentives of a risk-based system.

In addition, if U.S. banks are required to meet too high a leverage requirement, it would hamper their ability to compete internationally. If the leverage requirement requires most banks to increase their level of Tier 1 capital above the level required by risk-based capital then they will be at a competitive disadvantage.

Capital Standards As Minimums

All of the federal supervisors are implementing similar risk-based capital standards. Equally important, all the supervisory agencies have stated that these standards are minimums and that most banks will be expected to continue to operate with capital levels well above the regulatory minimums. The OCC and the FRB have both stressed that operating with capital ratios at regulatory minimums is acceptable only for institutions with high asset quality, diversified portfolios, and well managed on- and off-balance sheet activities.

One reason why supervisors view the risk-based capital standard as a minimum is that the standard contains only limited adjustments for other risks found in banks, including interest rate risk, foreign exchange rate risk, operational risk, and fiduciary risk. Although we have

not develop an explicit technique for capital charges for these other risks. In practice, an individual institution's capital adequacy will be based upon an examiner's quantitative and qualitative assessment of all the risks at the institution. Thus, national banks and Congress should understand that only the best managed banks will be considered adequately capitalized by the OCC if they operate with capital levels at the regulatory minimum. Compliance with regulatory minimums is only the first step in the determination of capital adequacy.

Of course, most banks recognize on their own that simply meeting minimum capital standards is not sufficient and they already maintain capital levels well above regulatory minimums. They strive to maintain protection not only against insolvency from unanticipated losses, but against the potential for failure to comply with capital standards.

Interest Rate Risk

In your invitation letter you asked that I comment on the methods the OCC is employing to account for the other risks that banks face, particularly interest rate risk. The OCC evaluates the level of interest rate exposure and the quality of risk management as part of our supervisory process. We are taking steps to improve our own examiner training and policy guidance on interest rate risk and we are participating in domestic and international efforts to improve the supervision of interest rate risk at banks.

Interest rate risk is the exposure of a bank's earnings and capital to future movements of interest rates. All banks assume interest rate risk as part of their normal banking operations. We require that banks prudently manage this risk, that exposures be adequately measured, and that capital be available to support the exposure. Unlike credit risk, which can be measured asset by asset and is linked to the bank's investments, interest rate risk should be examined on a portfolio basis. The sum of the interest rate sensitivities of individual instruments does not translate into the interest rate sensitivity of a portfolio of these instruments. The values of the instruments can move in different directions when interest rates change. Therefore, an instrument that is sensitive to interest rates may actually reduce the institution's interest rate exposure by countering exposures in other investments. Therefore, it is much more complex to assess the overall interest rate risk at an institution than it is to assess the overall credit risk. While a capital requirement associated with credit risk can be determined by an assessment of the risk of individual assets, interest rate risk can only be accurately measured if the entire portfolio is simultaneously examined.

The appropriate method for measuring the level of interest rate exposure at an institution depends upon the size and complexity of the bank. Appropriate methods range from simple, manually prepared reports of repricing imbalances to complex computer models.

Because of the wide variety of available interest rate sensitive investment and trading options, an institution's interest rate exposure can change quickly. Therefore, a periodic assessment of the level of exposure at an institution provides supervisors with only limited comfort that risks are controlled and capital protection is adequate. In addition to assessing the level of interest rate risk at an institution, it is important for the supervisor to insure that the institution's interest rate risk is prudently and comprehensively managed.

In evaluating an institution's interest rate risk management, the OCC looks to see that:

(1) the bank has a clear and explicit philosophy on the assumption and management of interest rate risk;

(2) the bank sets limits on the level of interest rate risk it is willing to assume;

(3) the bank appropriately measures its level of exposure to future interest rate movements; and

(4) the bank has procedures in place that link risk measurement and management decisions.

Based on our evaluation of the level of interest rate exposure at the institution and the management of this exposure, the OCC assesses the adequacy of the bank's capital. The OCC is participating in several efforts to improve this link between interest rate risk and capital adequacy. Domestically, we have implemented several regular training programs that are designed to enhance the ability of OCC examiners to assess the level of interest rate risk and the quality of risk management at national banks. Internationally, we are participating in a subgroup of the Basle Committee on Banking Supervision that is in the process of developing a comprehensive method for measuring an institution's interest rate risk. This measurement system will be tested in 1990 and 1991.

Determining Capital Levels — Accounting Methods

Capital requirements are not the end of the supervisory process. Three other elements are essential: (1) supervisors must insure that the accounting methods for

determining the amount of capital at an institution are fair and objective. (2) supervisors must take firm action to force corrective action and limit risk taking at undercapitalized institutions; and (3) supervisors must close an institution when capital is exhausted

Equity capital is the difference between an institution's assets and liabilities. Thus, the method by which individual assets and individual liabilities are valued and reported can significantly alter the reported equity at an institution. Commercial bank supervisors have developed uniform reporting standards for the quarterly report of financial condition and income filed by all commercial banks and Bank Insurance Fund (BIF) insured mutual savings banks.

Although the federal banking agencies have broad authority to establish their own rules for regulatory filings, regulatory reporting standards have substantially adhered to generally accepted accounting principals (GAAP). In a few instances, supervisory concerns have led us to implement more stringent requirements. We are constantly reviewing our reporting requirements, searching for methods to improve the accuracy of the reports of condition. In addition, the American Institute of Certified Public Accountants, along with the Financial Accounting Standards Board, is examining, and working to eliminate, the dfferences in bank GAAP and thrift GAAP. However, as you have recommended Mr. Chairman, we are not willing to make changes just to create consistency. Our objective is to make changes where they provide a fairer and more accurate reflection of the condition of the institution.

In recent years, GAAP and these reporting standards have come under increasing criticism. Under GAAP, many assets and liabilities are carried on the balance sheet at their historical costs, with subsequent changes in market value neither disclosed nor reflected in income or equity. The increased liquidity of some bank assets and the FDIC's increased failure resolution costs have heightened pressures for accounting based upon the market value of assets and liabilities.

In part, because many bank assets are long-lived and held to maturity, valuations have been traditionally based upon historical costs. Historical costs: (1) provide consistency across institutions and industries; (2) are relatively easy to measure; and (3) can be reasonably assumed to represent the fair value of the resource when it is acquired or expended.

This is not to say that accounting standards completely ignore changes in market values. When an institution enters into an activity with the intent of disposing of the asset before being repaid in full, bank supervisors and GAAP generally require reporting of the asset at the lower of cost or market value. This is because the institution's realization on this asset is sensitive to changing market and economic conditions. Even for assets carried at historical value, GAAP recognized changes in value due to credit losses and exposures. Identified losses must be charged off immediately. Anticipated, but not yet identified, credit losses must be reserved for in the allowance for loan and lease losses. Thus, the net value of an asset corrects for identified and anticipated credit losses.

I can appreciate the theoretical appeal of market value accounting. However, there are practical problems in applying market value accounting to the bank's entire balance sheet. First, the computation of market value is difficult and extremely sensitive to assumptions for assets or liabilities with limited or nonexistent markets. The market value of a bank's liabilities are particularly difficult to estimate. Secondly, market value accounting leads to increased volatility of earnings and equity because the entire balance sheet must be constantly readjusted to reflect changes in interest rates and market conditions. This would make it difficult for a bank to maintain capital adequacy because it would have to anticipate and correct for short-term changes in market conditions.

An analysis of the advantages and disadvantages of market value accounting is part of the Department of the Treasury's study of the deposit insurance system. The study will investigate the benefits of market value accounting and the costs of implementing the required recordkeeping and information systems. Any recommendation for increased reliance on market value accounting will be reflected in the recommendations of this study.

Supervision and Capital Adequacy

Capital standards are an important element of protecting the safety and soundness of the banking system. But they are not all that is needed. They are effective only if they are accompanied by strong supervision. Supervisors must make certain that each institution's reported condition is accurate and that problems are recognized and managed.

Usually, undercapitalization is the result of a gradual deterioration in asset quality, excessive growth, or uncontrolled operating expenses. Therefore, we do not focus only on institutions that fall below regulatory minimums. The OCC, through its supervisory policies, will usually have recognized an institution as a problem institution before its capital level falls below regulatory

minimums. This is one reason why there are over 100 more banks on our problem bank list than on the list of banks that do not meet current capital minimums

Like the other supervisory agencies the OCC devotes significant examiner resources to undercapitalized and other problem institutions When an OCC examiner identifies an undercapitalized institution, the examiner works with the institution to develop and maintain a plan to correct the problems and increase capital levels. Examiners also regularly review the bank's condition, the accuracy of its supervisory reports, its compliance with supervisory orders, its management quality, and its solvency In some cases we issue supervisory orders — for which failure to comply can result in severe penalties

Of course, supervisory actions and efforts by the institution's management will not insure that the institution does not fail. Banks must compete in the market place. As in any competitive environment, some institutions will find it impossible to compete. This year the OCC implemented a new closure rule that allows us to close an institution when its equity capital is eliminated. In the past, our policy was to close an institution when its primary capital — including the allowance for loan and lease losses — was exhausted. This allowed institutions to continue to operate even though the shareholder's financial interest in the institution no longer had any value The new equity insolvency rule allows us to close an institution while reserves still exist to cover anticipated and identifiable lsses This allows us to close institutions several months earlier than before the rule was adopted, limiting opportunities for excessive risk-taking by bank management In addition, the availability of the reserve to absorb losses, together with earlier closure, should decrease the average cost of failure resolution to the insurance fund

Conclusion

We recognize that capital adequacy together with strong supervision and timely closure are the principal lines of protection to the safety and soundness of the financial system and the protection of the insurance funds. Together with the other supervisors of insured depository institutions, the OCC is constantly searching for new methods to improve our measurement of capital and our determination and enforcement of capital adequacy. All the federal banking agencies approach capital adequacy using similar methods and have, or soon will have, similar minimum capital standards. By linking each individual institution's capital adequacy to qualitative and quantitative measures of risk, we are establishing a system where the more risky the bank's activity, the greater its required capital level.

Statement of Robert L. Clarke before the House Subcommittee on Financial Institutions Supervision, Regulation and Insurance, Committee on Banking, Finance and Urban Affairs, on deposit insurance reform, Washington, D.C., September 27, 1990

Mr. Chairman and members of the subcommittee, I am responding to your request to provide my views on H.R. 5590, the Bank Account Safety and Soundness Act. That bill, which you recently introduced, Mr. Chairman, represents a constructive effort to maintain the strength of the deposit insurance fund. Because H.R. 5590 would change the deposit insurance system in a fundamental way, it needs to be considered in the context of other actions that are being taken, particularly the Treasury Department study of deposit insurance mandated by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).

Condition of the Bank Insurance Fund

As the members of this subcommittee know from testimony heard in recent weeks by the full committee — and as all of us involved in bank supervision know from dealing with the industry every day — there are some serious areas of concern in the banking industry. The Bank Insurance Fund (BIF) balance as compared to the amount of insured deposits is at an all-time low; an additional decline is expected for this year. Moreover, as real estate markets in certain areas of the country continue to soften — and I expect that they will — the condition of many banks — some of them large — will decline as well.

In response to the need to ensure that the fund has adequate operating capital, The Board of Directors of the Federal Deposit Insurance Corporation (FDIC), of which I am a member, recently proposed to increase the deposit insurance premium for 1991 from 15 cents per $100 of domestic deposits, to 19.5 cents per $100 of domestic deposits — the maximum increase permitted under FIRREA. That would add $1.1 billion to the $3.7 billion in assessment income BIF would receive without the premium increase. If this increase is adopted, the rate commercial banks pay for deposit insurance will have increased by 135 percent since 1988.

Those are significant increases and will do much to alleviate concerns about the ability of BIF to deal with the problems in the banking industry. To be sure that the fund is able to meet any challenges in the coming months, the Treasury Department has transmitted to the Congress a legislative proposal that would provide additional flexibility for the FDIC to set deposit insurance rates. Similar to other bills that have been introduced in the Congress, Treasury's proposal would remove the statutory ceilings on the insurance premium and the limits on annual increases in the deposit insurance premium. Importantly, the proposal would grant the FDIC discretion in issuing assessment credits. That would allow the FDIC to build up reserves in the event of future periods of stress for the FDIC fund. Finally, the proposal would allow the FDIC to borrow from the Federal Financing Bank, thereby ensuring that the FDIC can obtain working capital at a favorable rate.

Provisions of H.R. 5590

The provisions of H.R. 5590 requiring insured banks to make and maintain deposits with BIF equal to one percent of total deposits would also provide BIF with additional resources, but it would represent a major change in the way we fund deposit insurance. In effect, H.R. 5590 would create an ex post system of deposit insurance in which all banks shared proportionally in the cost of bank failures immediately upon the occurrence of the failure. It would more clearly place the capital of banks in front of taxpayers, and would lead to automatic increases in bank contributions to BIF if industry conditions lead to a depletion of BIF. All of the implications of such a system — for example, its effects on bank earnings at a time of stress in the industry — must be thoughtfully considered.

The Congress recognized the importance of carefully weighing alternatives for restructuring deposit insurance when it included in FIRREA a provision mandating an 18-month study of deposit insurance reform. That study, which is being conducted by the Treasury Department in consultation with the federal supervisors of depository institutions, the Council of Economic Advisors, and the Office of Management and Budget, will examine a wide range of issues related to deposit insurance and make recommendations for reform. Only by looking at all proposals through this process can we make certain that we select the best available options for addressing the problems before us.

Because of the importance of deposit insurance reform, the Treasury Department is working hard to complete the report ahead of schedule. Given its imminence, major reform should not be undertaken before that study is completed. Eliminating restrictions on the ability of the FDIC to raise the premium will ensure that we have the time that is necessary to consider more fundamental changes to deposit insurance, such as H.R. 5590.

In the remainder of my statement today, I will try to place the question of deposit insurance reform in perspective, and I will offer my ideas on how we should proceed over the next few months.

Deposit Insurance in Perspective

The 1980s was a time of great upheaval in the financial services industry. Although economic growth was strong, several sectors of the economy — most notably agriculture and energy — experienced severe problems, and, during that decade, 1,012 commercial banks failed. By comparison, 556 insured commercial banks failed in the first 47 years of the FDIC's existence. We also witnessed the collapse of the fund that insured deposits in the thrift industry, which culminated in a massive rescue operation, for which the taxpayers will be paying for years to come. As we move into the 1990s, well-documented problems in several regional real estate markets will pose continuing challenges for commercial banks and their supervisors.

The reports from our examiners make it clear that while the banking system as a whole is sound, there are areas of significant concern. There are weaknesses in a number of markets, particularly real estate, and that has already affected some banks profoundly. At year-end, we expect the number of troubled national banks to be about 350 — nine percent of all national banks. In addition, if conditions in certain markets deteriorate, some institutions that are not now on the troubled list will likely require increased supervisory attention. Thus, we must make sure that BIF has the resources to continue to promote confidence in the banking system. Although I have these concerns, I do not agree with the alarmist reports about the condition of the banking industry and the deposit insurance fund. Those dire forecasts receive too much publicity and should not form the basis of our policy deliberations. As we consider the current situation, we must make sure our debate is rooted in reality and fact.

Attempts to draw a parallel between the current situation and conditions immediately preceding the creation of the FDIC are unwarranted. In the 1920s, bank failures averaged 635 per year. From 1930 to 1933, over 9,000 banks failed, as GNP fell by 46 percent. By contrast, although many banks failed in the 1980s, the problems were not the result of general weakness in the economy, nor were they systemwide. On the contrary, GNP rose by 28 percent in the 1980s. In the aggregate, the banking industry earned over $150 billion and equity capital in the system rose by 88 percent from $107 billion to $201 billion.

Most important, bank failures today do not have the devastating impact on communities that failures had in the early 1930s. The deposit insurance system has proven that it protects depositors. The deposit insurance fund has declined over the past several years because deposit insurance was doing what it was created to do — protecting depositors. From 1986 through 1989, banks that either failed or required FDIC assistance had assets that totalled approximately $100 billion. FDIC spent more than $17 billion over that period. The proven strength of deposit insurance in dealing with weaknesses among insured banks is reason enough for us to proceed carefully before adopting significant changes in our deposit insurance system.

This is not to say that improvements to the current system are not necessary, but we must keep in mind that modifying deposit insurance has the potential to affect broadly the operation of the banking system, public confidence in that system, and the ability of the banking system to support a strong economy. Among other things, one test of any change to deposit insurance should be how it affects the ability of the banking system to continue to provide vital financial services to businesses and consumers. Ultimately, the profitability of the banking industry and the financial condition of the insurer are interrelated, and together will determine whether the banking industry remains safe and sound. If ever-higher premiums cause bank capital to shrink, or if at the limit, they push a significant number of banks into insolvency, deposit insurance will not promote the vitality of the banking industry.

Deposit insurance is a critical component of maintaining confidence and promoting the stability of our banking system, but it is not the only component. Addressing our current problems by focusing on deposit insurance alone would be shortsighted. Fortunately, we have additional options — enforcing strong bank capital requirements and actively supervising banks. Strong capital requirements ensure that owners have significant amounts of their capital at risk, and help to insulate taxpayers from failures in the banking system. Strong supervision encourages sound management and makes bankers properly value their assets and reserve for future losses from current earnings. In addition to considering how to reform deposit insurance, I believe we must focus our energies on capital requirements and bank supervision as well. The OCC is doing just that.

Capital Standards

Capital plays a fundamental role in maintaining the safety and soundness of the banking system. By protecting banks from insolvency, capital reduces the potential exposure of taxpayers from the costs of bank failure. Thus, strengthening capital standards can ac-

complish a similar purpose as increasing the balance of the insurance fund above historical target levels. Strong capital standards, however, go further. By ensuring that investors' funds are at risk, they give investors an incentive to pressure bank managers to operate efficiently and compete effectively, strong capital standards also decrease the willingness of banks to take imprudent risks with insured deposits.

In 1989, the OCC, the Board of Governors of the Federal Reserve System, and the FDIC adopted common risk-based minimum capital standards for insured commercial banks based upon the Iternational Capital Accord developed by the Basle Committee on Banking Supervision. As a result of these standards, at the end of this year, banks will be expected to have total capital equal to at least 7.25 percent of risk-weighted assets. When risk-based capital is fully phased in, at year-end 1992, banks will be required to have total capital equal to at least 8 percent of risk-weighted assets. I say at least 8 percent because most banks will need to hold more capital than that. The reason is that the international risk-based capital standards contain only limited adjustments for some important risks found in banks, such as interest rate risk, foreign exchange rate risk, operational risk, and fiduciary risk. Nor do they account for differences in asset quality within broad categories of credit risk. The OCC, therefore, will provide examiners with guidance for determining how much capital above the risk-based minimum individual banks will be required to hold.

Risk-based capital is an important improvement over current capital standards. The new standards redefine capital to increase a bank's ability to absorb unanticipated losses: At least one-half of a bank's regulatory capital consists of core capital (primarily common shareholder's equity, noncumulative perpetual preferred stock, and related surpluses). The allowance for loan and lease losses (ALLL) — which is designed to account for anticipated losses and thus offers limited capital support — is restricted in the determination of regulatory capital to 1.25 percent of risk-weighted assets. In the past, a bank could meet minimum requirements by relying entirely upon the ALLL. Furthermore, the new requirements will force banks to hold more capital for riskier assets and to incorporate explicitly off-balance sheet activities into the calculation of minimum capital levels.

The risk-based capital standards are tough. At the 8 percent minimum, the risk-based capital guidelines will significantly increase the total capital required in the banking system and require the greatest increase at multinational and large regional institutions — the institutions that, because of their size, present the greatest risk to the banking system and to the deposit insurance fund. Based upon March 1990 data, we estimate that:

(1) If the insured commercial banks that do not meet the risk-based capital standards were to make no changes that affect risk-weightings in their portfolios, they would need to raise an additional $24 billion in capital to meet the fully phased-in risk-based capital standards. Of that $24 billion, $18 billion would have to be raised by banks with assets in excess of $10 billion.

(2) As of March, 1990, 562 out of 12,414 insured commercial banks that hold 36 percent of all the assets in the banking system did not meet the minimum requirements and, thus, still needed to make further adjustments in order to comply with the standards by final implementation on December 31, 1992. By comparison, on the same date, only 457 insured commercial banks, accounting for only 3 percent of assets failed to meet the old capital minimums, which will expire on December 31, 1990.

Supervision

Asset Quality Reviews

Strong capital standards are not meaningful if they are not backed by strong supervision. Recent criticisms of the OCC's supervision — and, in particular, charges that we are not putting enough effort into reviewing asset quality — reflect a fundamental misunderstanding of how we supervise national banks. Let me correct that misunderstanding. The OCC does thorough examinations at least annually of the national banks that hold the bulk of the assets in the banking system. The vast majority of that work is done in the banks.

Because of the risks in lending, we spend a great deal of time reviewing asset quality at national banks. One aspect of that effort is the joint review of credits that we conduct with the Federal Reserve and the FDIC through the Shared National Credits program and the interagency review of the international credit exposure of U.S. banks.

Large syndicated loans, those in excess of $20 million, are reviewed each year by the OCC, Federal Reserve, and the FDIC through the Shared National Credits program. The total dollar volume of credits in the program has increased from approximately $390 billion in 1986 to $768 billion in 1990. These credits account for

more than 35 percent of commercial loans and loan commitments in all banks and include many of the large real estate loans and most highly leveraged transactions (HLTs) in which banks are involved. For each of the past five years, the OCC has provided half of the staff time that the supervisory agencies devote to this effort.

The OCC also participates with the Federal Reserve and the FDIC in the Interagency Country Exposure Review Committee (ICERC), which meets three times a year to review U.S. bank credit exposures to sovereign nations. Using information from a wide variety of international and domestic sources, including examinations of the major banks that hold this debt, ICERC evaluates transfer risk exposure for each nation.

The supervisory activities we conduct in national banks reflect our policy of focusing on the areas of greatest risk. There are 215 national banks with assets of more than $1 billion. Those banks, which are owned by 123 holding companies, have assets that total $1.6 trillion — 80 percent of the assets in the national banking system. In 1989, OCC examiners reviewed loan portfolios in national bank subsidiaries of 111 of the 123 large bank companies. In the first six months of this year, we examined loan portfolios in 78 of those companies. Since January of last year, the OCC has conducted asset quality reviews at least once — and in many cases more than once — in 99 percent of the large bank companies.

Placing Resident Examiners in Large National Banks

The 215 large national banks include 41 that are affiliated with our seven largest multinationals. Those 41 banks have $606 billion in assets — 30 percent of the assets in the national banking system. For that reason, the OCC has, since 1985, had full-time, resident examiners in each national bank that is the lead bank of a multinational. To monitor the operations of those banks, our full-time presence in those banks is being expanded. By year-end, the examination teams in those banks will range from 7 to 10 members. As the regional banks grow in size and complexity, a similar program is applied to them. In both cases the resident examiners are supplemented by additional examiners as needed to conduct specialized examinations and asset quality reviews.

Conducting Specialized Examinations

Because of our concern with asset quality, and the growth in real estate lending by national banks, the OCC has made real estate loans a primary focus of our examinations in 1989 and 1990. Since October 1, 1989, we have conducted 167 focused real estate examinations at national banks with assets of more than $1 billion. Together those banks account for more than 61 percent of the assets in the national banking system. Although those examinations focused on real estate, in many of the banks our examiners reviewed other aspects of the bank's operations including commercial and industrial loans, consumer loans, interest rate risk, and liquidity.

I am providing this information on our examination efforts to make it clear that the OCC is serious about our responsibility to supervise national banks. Bankers are well-aware of the OCC's supervisory efforts. They have been quite vocal about our examinations, so you know we are in the banks. Indeed, I testified on that issue at a hearing you held in Chicago last May, Mr. Chairman, and I have met on numerous occasions with other members of Congress, local public officials, banking groups, and borrower groups to address concerns about the intensity of our examinations.

Our asset quality reviews in areas of the loan portfolio for which we have concerns are nothing new. In 1985, we focused on real estate in the Southwest. More recently, in 1987, when we first detected some softening in real estate markets outside the Southwest, we began a review of the real estate lending practices at a number of banks operating in those markets. We stepped up those efforts in 1988, when OCC examiners in our Southeast District examined the real estate lending practices at 13 of the regional banks that had the greatest real estate exposures in that district. Our examiners emphasized the need for improved lending standards and controls and alerted bank managers to the potential for losses if weaknesses went uncorrected. We communicated our concerns more widely to the banking industry in 1988 through an advisory letter sent to the chief executive officers of all national banks. That letter warned of risks of excessive concentrations in real estate lending and cited some deficiencies that we had found in our examinations of the regional banks. Our focus on emerging risks is also indicated by our efforts regarding highly leveraged transactions. The OCC took the lead in evaluating — and ultimately criticizing — the quality of HLT underwriting by commercial banks. In the spring of 1988, we initiated a study of HLTs at 16 of our largest institutions. We followed up our fact-finding with an examining circular that gave examiners detailed guidelines for reviewing bank HLT financing policies. The OCC published a handbook in April 1989, which describes practices banks have found to be effective in managing their HLT activities. Those anticipatory actions contributed to our knowledge of the business, and better

positioned our examiners to determine the quality of HLTs in national banks.

Early Intervention into Problem Banks

Strong supervision, however, involves more than understanding the risks present in banks. It also requires early intervention when the condition of a bank deteriorates. That is exactly what we do. National banks that fall below required capital levels must file with us a plan for meeting our capital standards. Capital deficient banks frequently seek new investors, but today, because of difficulty in raising capital, a bank might find it more realistic to shrink in size or reconfigure its balance sheet to comply with our capital standards. If such steps do not succeed, we take more severe measures. These actions might include requiring the development of an agreed upon schedule for raising capital or restricting or eliminating dividend payments. In addition, under powers granted by FIRREA, if management of a bank fails in its efforts to address the problems of the bank and the ondition of the bank continues to deteriorate, the OCC can appoint a conservator.

In the end, despite our best efforts to work with the managers of troubled institutions, some banks will not survive. Supervisors must take prompt action when banks reach that point. This year the OCC implemented a new closure rule that allows us to close an institution when its equity capital is depleted. In the past, our policy was to close an institution when its primary capital — including the allowance for loan and lease losses — was exhausted. That approach allowed institutions to continue to operate even though the shareholder's financial interest in the institution no longer has any value. The equity insolvency rule enables us to close an institution while reserves still exist to cover anticipated and identifiable losses. This allows us to close institutions much earlier than we could have before the rule was adopted, limiting opportunities for excessive risk-taking by bank management. In addition, the availability of the reserve to absorb losses, together with earlier closure, should decrease the average cost of failure resolution to the insurance fund. We would like to consider additional measures to close failing banks sooner, but we must be sure that the steps we take would not result in an unconstitutional taking of private property. Even the possibility of that happening would discourage investors from putting their capital in banks.

Conclusion

Mr. Chairman, we all recognize that there are some serious challenges ahead for the banking industry. Thoughtful action about how to ensure that it can continue to maintain the confidence of the public and serve the credit needs of our nation is needed. H.R. 5590 represents a constructive contribution to that process, and it deserves careful consideration within the context of other suggestions for reform. Those who would reform deposit insurance, however, must not ignore the substantial contributions to stability and confidence that strong capital requirements and active supervision play in putting private capital — rather than public funds — at risk. Holding bankers accountable for the safe and sound operation of their institutions plays a vital role in that process.

Interpretations — July 1 to September 30, 1990

Interpretive Letters*

509 — July 2, 1990

This letter pertains to notice filed by * * * ("the Bank") of its desire to expand the activities of its subisidary, * * * ("FRM"). OCC approved the establishment of FRM on December 26, 1989, to collect debts and manage and liquidate assets acquired in satisfaction of debts previously contracted for its parent. The OCC also approved FRM's engaging in such activities for the Resolution Trust Corporation ("RTC") pursuant to the provisions of an interim servicing agreement between the RTC and the Bank that was a requisite part of the * * *, 1989 purchase and assumption transaction through which the Bank acquired certain of the assets and liabilities of the former * * * FSA * * * ("* * *").

The bank recently advised the OCC of its desire that FRM, if successful as a bidder, be able to contract with the RTC to function as the RTC's agent in the liquidation of loans and other assets retained by that agency in its capacity as receiver for FSA.

Such undertaking would occur through execution of a standardized "Asset Management and Disposition Agreement" ("the Agreement") adopted by the RTC in June of this year. Under this Agreement, FRM would agree to assume responsibility for a pool of assets, composed of loans and real estate, held by the RTC in its role as receiver of FSA. Upon preparation of business plans for the management and disposition of such assets, FRM would provide asset management services and dispose of such assets in accordance with the Agreement and specific plans developed thereunder. You have represented that FRM would comply with the mandatory subcontract provisions of such Agreement under which subcontracts with unaffiliated third parties would be negotiated for the provision of, among other services: property management, maintenance, and leasing; appraisal services; and commission brokerage services for sales and rentals.

Having considered the above-referenced proposal, approval is given to the proposed execution by FRM of the Agreement with the RTC subject to the above-referenced understandings and representations made on behalf of the Bank. This approval is limited to the servicing and liquidation, including the exercise of default remedies, of assets formerly held by FSA pursuant to the Agreement. It does not constitute authorization for FRM or the Bank to engage in asset management activities for the RTC outside the context of debt collection and liquidation of FSA's former assets.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

510 — June 19, 1990

I am writing in accordance with our agreement to provide the Federal Agricultural Mortgage Corporation with a decision on the Diversified Subordinated Interest proposal within approximately 45 days.

The OCC has considered the proposal, as submitted by the American Bankers Association on July 12, 1989, and as supplemented by your memorandum dated May 2, 1990, and made determinations regarding national bank participation in the program within the context of the proposal. We are in the process of writing a comprehensive statement which will provide clear guidelines for banks to follow. The information will be published in the form of a banking circular which will be sent to all national banks and you.

Based on the proposal as submitted, the summary of the decision is as follows:

1. The outstanding balance of a loan sold into the Farmer Mac Program will not be included in the calculation of the legal lending limit for that borrower, where the loan becomes part of a pool and a portion of the subordinated interest in the pool is held by the bank through the acquisition of a security representing an undivided subordinated interest in the diversified Farmer Mac loan pool. The amount of subordinated securities acquired by a bank may not exceed the 10 percent reserve on each loan sold into the Farmer Mac pool.

2. The total of all retained subordinated interests in loans together with all diversified subordinated interests held by a bank as a result of participation in the Farmer Mac program may not exceed 25 percent of the bank's capital.

3. The purchase of a diversified subordinated interest in a Farmer Mac pool is permissible

*Note: Intepretive Letters and No Objection Letters reflect the views of the Comptroller's legal staff. Trust Intepretations reflect the views of the Trust Activities Division; Investment Securities Letters reflect the views of the Investment Securities Division.

only in connection with a bank's sale of a loan into that pool.

4. Effective December 31, 1990, the risk-based capital guidelines will apply to all transactions, including any Farmer Mac transactions done in 1990.

   Accordingly, the sale of a bank's loan into a Farmer Mac pool in conjunction with the bank's purchase of a subordinated security will be treated as a sale with recourse for purposes of current and risk-based capital.

After you have reviewed the banking circular containing the comprehensive discussion of these matters, please feel free to contact my office with any questions you may have.

Donald G. Coonley
Chief National Bank Examiner

* * *

511 — June 20, 1990

This responds to your inquiry concerning the proposal of * * * ("Bank") to swap, through a series of interrelated transactions, certain rescheduled loans to Argentine public sector companies that are guaranteed by the Republic of Argentina ("GRAs") for debt of, and subsequently equity in, * * * ("AAAA") and * * * ("BBB"). In your view the proposal is permissible under national banks' long-established power to acquire and own equity in exchange for releasing a debt previously contracted ("DPC").

Background

AAAA is a private corporation, organized under the laws of the Republic of Argentina, that engages in * * *. AAAA's principal shareholder is * * *, who currently owns about * * * percent of AAAA's outstanding common stock. Its remaining shares are publicly held in Argentina. AAAA has been operating under the Argentine equivalent of Chapter 11 of the U.S. Bankruptcy Code since 1982. During this period various Argentine government banks and other government sector entities have made substantial loans to AAAA. At the present time, about * * * percent of AAAA's debt is to these Argentine government entities.

BBB is also a private corporation organized under the laws of the Republic of Argentina. BBB is a 51 percent-owned subsidiary of AAAA that was formed to * * *. Currently, about * * * percent of BBB's debt is to Argentine public sector entities.

You indicate that the proposed transaction is designed to improve the Bank's prospects for making a recovery on the GRAs that it currently owns (both the GRAs that will be swapped in this transaction and those that will be retained) by swapping GRAs for equity in recapitalized and viable companies — AAAA and BBB. As an essential intermediate step, the GRAs will first be exchanged for debt of AAAA and BBB. Such AAAA and BBB debt will then be used to effectuate a recapitalization of AAAA and BBB through an exchange of such debt for equity.

You note that the Republic of Argentina would not permit the direct swapping of GRAs for AAAA and BBB equity. The Bank would not be interested in receiving AAAA and BBB debt in satisfaction of GRA's unless, as part of the same transaction, AAAA and BBB were recapitalized.

In the first step, the Bank will exchange GRAs with a face amount of * * * million (and a book value of * * * million after reserves) in return for loans from Argentine government entities to AAAA or BBB. This first step has two components. About * * * million face amount (book value of * * * million) of GRAs will be exchanged for AAAA debt denominated in Argentine currency with a face value equivalent to about * * * million. About * * * million face amount (book value * * * million) of GRAs will be exchanged for BBB debt denominated in Argentine currency with a face value equivalent to about * * * million. The GRAs will effectively be extinguished in these exchanges.[1]

Second, the Bank will capitalize a new U.S. operating subisidary and transfer the AAAA and BBB debt to it. The operating subsidiary will in turn transfer the AAAA and BBB debt to a new Argentine company ("ABC Company") in return for 100 percent of the stock of ABC Company.

The recapitalization of AAAA requires the approval of its shareholders. As a result, you state that the third step has been designed to ensure that such approval will be obtained. Specifically, ABC Company will pay a * * * million performance fee * * *

* * * will transfer to the Bank, as trustee, * * * percent of AAAA's outstanding shares, with instruction to deliver

[1]The GRAs so exchanged will be held by an Argentine government * * * that is also a creditor of the Republic of Argentina. Consequently, Argentina's external debt will be reduced by the amount of the exchanged GRAs.

the shares held in trust to Newco (as defined below), if * * * is not successful, to a subsidiary of the Bank

Fourth, ABC Company will contribute about * * * million face amount of AAAA debt to a second Argentine company ("Newco") in exchange for 50 percent of Newco's common stock. The remaining AAAA debt will be retained by ABC Company and, as described below, will be exchanged for shares of AAAA. As described in connection with the next step, * * * will own the remaining 50 percent of Newco and will also contribute AAAA debt and stock to it. You indicate that ownership of stock in Newco will permit the Bank to exercise effective management control of AAAA and thus better ensure recovery on the Bank's assets.

Fifth, after the shareholders of AAAA approve the issuance of the additional shares required to consummate the transaction, the Bank will transfer the AAAA shares held by it in trust to Newco. As the result of the delivery of those shares to Newco and the contributions of additional AAAA debt by * * * to Newco, * * * will receive 50 percent of Newco's common stock.

Sixth, Newco will borrow the equivalent of * * * million in Argentine currency and will use such amount to purchase additional outstanding AAAA debt equivalent to about * * * million. * * * will guarantee the equivalent of * * * million of the Newco borrowings.

Seventh, both ABC Company and Newco will exchange the AAAA debt they own with AAAA in return for shares of common stock of AAAA. The AAAA debt will be extinguished. The Bank's * * * branch may provide a loan to Newco for a portion of the * * * million borrowing if necessary to ensure completion of the recapitalization of AAAA.[2]

At the end of the AAAA portion of the proposed transaction, the Bank and * * * will each control * * * percent to * * * percent of AAAA's shares.[3] The Bank and * * * will enter into a shareholders' agreement concerning Newco for the administration of AAAA shares. Each will own at least * * * percent of AAAA's shares directly (through the U.S. operating subsidiary, and ABC Company in the case of the Bank), Newco will own about * * * percent to * * * percent. This structure gives both the Bank and * * * the flexibility to sell their independent interests in AAAA, while ensuring that, through Newco, they will continue to be able to exercise effective control over AAAA.

After debt financing necessary to completion of BBB's operating plant has been arranged, ABC Company will exchange its BBB debt for approximately * * * percent of BBB's common stock. The BBB debt that was exchanged will be extinguished as part of the transaction.

At the completion of the proposed transaction, both AAAA and BBB will have been recapitalized. The Bank believes that its stock in recapitalized AAAA and BBB will enable it to recover a substantial portion of the face amount of the GRAs it swaps and to recover substantially more than it could realize by continuing to hold the GRAs.

Legal analysis

The authority of national banks to acquire and hold equity securities in order to improve the prospects for recovery on loans that are in default, are nonperforming, or otherwise have a documented history of poor performance is indisputably established. This authority has been recognized by the courts, *see First National Bank of Charlotte v. National Exchange Bank of Baltimore*, 92 U.S. 122, 127 (1875) ("In the honest exercise of the power to compromise a doubtful debt owing to a bank, it can hardly be doubted that stock may be accepted in payment and satisfaction."); *Atherton v. Anderson*, 86 F.2d 518, 525 (6th Cir. 1936), *rev'd on other grounds*, 302 U.S. 643 (1937) ("It has generally been thought, however, and we think the view is nowhere seriously disputed, that a bank has implied power when faced with a loss growing out of a legitimate banking transaction to acquire stocks or other property when it is honestly believed at the time that under more favorable circumstances a loss which would otherwise accrue might be averted or diminished."), and by the OCC, both in its regulations, *see* 12 CFR 1.11 ("restrictions and limitations [on holding investment securities] do not apply to securities acquired in good faith by way of compromise of a doubtful claim or to avoid a loss in connection with a debt previously contracted") and in Interpretive and No Objection Letters, *see* OCC No Objection Letter No. 87-10, *reprinted in* [1988-89 Transfer Binder] Fed. Banking L. Rep. ¶ 84,047. Shepherd and Clock, "Regulatory Aspects of Developing Nation Debt-Equity Swaps," 12 Fordham Int'l L.J. 43, 45 (1989) (citing cases). The OCC has explained that this authority to

[2]Because AAAA will need working capital to fund its ongoing operations after completion of the proposed transactions, the Bank's * * * branch will provide AAAA with an Argentine currency-denominated working capital facility in an amount equivalent to * * * million. This facility will be on fair market terms and conditions.

[3]The total ownership stake cannot be precisely determined in view of the subscription rights of existing AAAA shareholders to any newly issued shares.

DPC property in satisfaction for a debt previously contracted.

> originates from two sources: 12 U.S.C. 29 which, among other circumstances, permits national banks to hold real property in satisfaction of debts previously contracted; and 12 U.S.C. 24 (Seventh), relating to national banks' incidental powers, which, along with judicial precedent and analogies to 12 U.S.C. 29, authorizes the holding of equity securities by national banks in satisfaction of debts previously contracted.

OCC No Objection Letter No. 87-10, *supra*

In the proposed debt for equity swap transaction, the Bank will acquire stock in Newco DPC. As a company in which the Bank holds stock pursuant to its DPC authority, Newco is not bound by the usual restrictions that apply to the operations of national banks and therefore can borrow money for the purpose of recapitalizing its holdings — AAAA and BBB. This will result in the payment of outstanding AAAA debt, the anticipated removal of AAAA from bankruptcy, and Newco's acquisition of additional AAAA stock in exchange for the payoff of the debt.

Although the holding of Newco stock is permissible under the Bank's DPC authority, it should be noted that DPC property must be disposed of as soon as possible. The maximum holding period for DPC property (including stock) is five years, although the OCC may extend the holding period for up to an additional five years for good cause. In no event, however, can DPC property be held longer than this period as extended. If the Bank has reason to believe that it might not be able to comply with the holding period limitation, it should not proceed with the proposal.

Based on the facts and circumstances as described, I have no objection to the Bank's acquisition of Newco DPC and the subsequent recapitalization of Newco's holdings, *i.e.*, AAAA and BBB. It should be noted that the applicability of various banking laws such as 12 U.S.C. 84 and 371c to Newco are not addressed here, and that the analysis accepted herein is based on the unique circumstances under which national banks are permitted to acquire DPC property under existing precedent when the borrower is not a foreign sovereign.

William B. Glidden
Assistant Director
Legal Advisory Services Division

* * *

512 — July 9, 1990

This is in response to your request for confirmation that securities fully guaranteed by the Federal Agricultural Mortgage Corporation ("Farmer Mac") under Title VIII of the Farm Credit Act of 1971, as amended, are eligible for unlimited purchase, holding, dealing in, and underwriting by national banks. This letter will confirm your understanding.

DESCRIPTION OF FARMER MAC

The Federal Agricultural Mortgage Corporation, commonly known as "Farmer Mac," was created by the Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568. Title VII of the Agricultural Credit Act amended the Farm Credit Act of 1971 by adding a new Title VIII, codified at 12 U.S.C. 2279aa *et seq.*, entitled "Agricultural Mortgage Secondary Market."

This new title established Farmer Mac, a federally chartered instrumentality of the United States and an institution of the Farm Credit System. 12 U.S.C. 2279aa-1(a). Its purpose is to facilitate the creation of a secondary market for qualified loans secured by a first lien on agricultural real estate. Congress believed that such a secondary market would serve to increase the availability of long-term credit to farmers and ranchers at stable interest rates, provide greater liquidity and lender capacity in extending credit to farmers and ranchers, and provide an arrangement for new lending to facilitate capital market investments in providing long-term agricultural funding, including funds at fixed rates of interest. 12 U.S.C. 2279aa note.

Farmer Mac's primary responsibilities include the development of uniform underwriting guidelines for secondary market loans; the certification of agricultural mortgage marketing facilities authorized to pool and issue securities representing interests in, or obligations backed by, pools of qualified loans; and the provision of guarantees for the timely payment of principal and interest on such securities or obligations.

Farmer Mac will establish uniform underwriting, security appraisal, and repayment standards for qualified loans underlying the securities that it guarantees. The standards must, so far as practicable, limit qualified loans to those that are deemed by Farmer Mac to be of such quality as to substantially meet the purchase standards imposed by private institutional mortgage investors. 12 U.S.C. 2279aa-8.

Farmer Mac is also responsible for issuing standards for the certification of, and for certifying, the agricultural mortgage marketing facilities that issue the securities guaranteed by Farmer Mac. The Farm Credit Act sets

forth certain minimum requirements that such facilities must meet to be certified, and Farmer Mac may revoke the certification of a marketing facility if it no longer meets those standards. 12 U.S.C. 2279aa-5.

The third major activity of Farmer Mac involves guaranteeing the timely payment of principal and interest on pool securities issued by the marketing facilities. A facility must maintain either a subordinated interest in the loan pool or a reserve upon which the facility must draw in the amount of at least 10 percent of the outstanding principal amount of the loans before it makes demand on Farmer Mac's guarantee. 12 U.S.C. 2279aa-6(b). Thus, Farmer Mac is obligated to pay no more than 90 percent of the principal and interest due on the securities, and is obligated to do so only if the reserves or subordinated interest have been established as mandated by statute. Certain other statutory requirements must also be satisfied by a facility before Farmer Mac may guarantee the facility's securities. 12 U.S.C. 2279aa-6(d).

Farmer Mac's primary sources of funding for the payment of claims made on its guarantees are the fees it charges to the agricultural loan marketing facilities that it certifies. 12 U.S.C. 2279aa-10(b). Securities guaranteed by Farmer Mac are not obligations of the United States, nor does Farmer Mac's guarantee represent a pledge of the full faith and credit of the United States. 12 U.S.C. 2279aa-12(a)(2). However, Farmer Mac is authorized to borrow up to $1,500,000,000 from the Secretary of the Treasury if necessary to fulfill its guarantee obligations. 12 U.S.C. 2279aa-13.

Discussion

Section 16 of the Glass-Steagall Act, 12 U.S.C. 24(Seventh), generally prohibits national banks from underwriting, dealing in, or purchasing securities for their own account. The ban on underwriting and dealing in securities, however, is not absolute. Section 16 contains a number of exceptions to the general prohibition, and one of these relates to "obligations issued under the authority of the Federal Farm Loan Act, as amended. . . ." Thus, under 12 U.S.C. 24(Seventh), it is permissible for national banks to deal in, underwrite, and purchase for their own account such obligations.

The Federal Farm Loan Act was repealed by section 5.26(a) of the Farm Credit Act of 1971, Pub. L. No. 92-181, 85 Stat. 583, 625. However, that section provided that "[a]ll references in other legislation, State or Federal, . . . to the Acts repealed hereby shall be deemed to refer to comparable provisions of this Act." 12 U.S.C. 2001 note. Thus, the reference in 12 U.S.C. 24(Seventh) to the "Federal Farm Loan Act" should now be read as the "Farm Credit Act of 1971." In other words, by virtue of section 5.26(a) of the Farm Credit Act of 1971, section 16 of the Glass-Steagall Act, 12 U.S.C. 24(Seventh), authorizes national banks to underwrite, deal in, and purchase for their own account securities issued under the authority of the Farm Credit Act of 1971.

Securities fully guaranteed by Farmer Mac clearly qualify for the exception in section 16 of the Glass-Steagall Act. First, such securities will be "obligations" because they will represent participations in, or obligations backed by, pools of mortgage loans, i.e., debt obligations. Second, the securities will be issued "under the authority of" the Farm Credit Act of 1971 because title VII of the Agricultural Credit Act of 1987, the statute creating Farmer Mac and setting up the securities issuance and guarantee framework, was an amendment to the Farm Credit Act of 1971. Title VII of the Agricultural Credit Act is, in fact, title VIII of the Farm Credit Act. Agricultural Credit Act of 1987, 702, 101 Stat. 1686.

Admittedly, this background is complex. It is understandable that some in Congress were unaware that national banks would be able to underwrite Farmer Mac-guaranteed securities, without express language to that effect, by virtue of the Federal Farm Loan Act provision. *See*, e.g., 13 Cong. Rec. H11872 (daily ed. December 18, 1987); 133 Cong. Rec. E5008 (daily ed. December 21, 1987). Nevertheless, the statutory framework compels this result.

For these reasons, I concur with your opinion that securities fully guaranteed by Farmer Mac under title VIII of the Farm Credit Act of 1971, as amended, are eligible for unlimited purchase, holding, dealing in, and underwriting by national banks, pursuant to the authority contained in 12 U.S.C. 24(Seventh).

This opinion is limited to securities that are fully guaranteed by Farmer Mac. The Office of the Comptroller of the Currency takes no position at this time with respect to any other Farmer Mac securities. The status and regulatory treatment of other securities that may be issued under the Farmer Mac program will be addressed in the near future in a forthcoming banking circular.

Paul Allan Schott
Chief Counsel

* * *

This responds to the application by the Colorado National Bank of Denver (the "Bank") to expand the activities of its bank service corporation, Colorado National Service Corporation ("BSC"). For the reasons set forth below, we have concluded that all of the new activities proposed are permissible.

The Bank's Proposal

BSC plans to perform activities which may be divided into the following three categories:

I. Services of a clerical, bookkeeping, and accounting nature to be performed for other depository institutions consisting of:

1. proof of deposit services, including without limitation item processing, item sorting, item encoding, and check clearing;

2. check-related bookkeeping and accounting services, including without limitation account balancing, check posting and filing, return item processing, and exception item processing;

3. account adjustment services, including without limitation account research and reconciliation;

4. clerical, bookkeeping and accounting services and check sorting and posting services to support cash management services offered by depository institutions to their customers;

5. clerical, bookkeeping, and accounting services to support the lending operations of depository institutions;

6. clerical, bookkeeping, and accounting services to support trust department activities of depository institutions;

7. preparation and mailing of statements, checks, notices, and similar items for depository institutions;

8. utilization of electronic data processing equipment to post debits and credits and provide other accounting services to support wire transfers, depository services, lending services, cash management services, and other banking services offered by depository institutions to their customers;

9. design, preparation, and management of forms for statements, notices, and other banking related items;

10. document storage, retention, and retrieval and any other clerical, bookkeeping, accounting, statistical, or similar functions required to support the operation of a depository institution.

II. Services to be provided to unaffiliated financial institutions in Colorado consisting of:

1. bank mailroom processing, including without limitation sorting and routing of incoming and outgoing mail;

2. bank communications support services, including without limitation establishment and administration of an electronic network for transmission of visual, voice, and data communications;

3. courier services for checks, commercial paper, documents, and nonnegotiable instruments exchanges among financial institutions, and for audit and accounting media and other business records and documents related to banking.

III. Services to be provided to the Bank's parent holding company and its subsidiaries consisting of:

services for the internal operations, such as purchasing of equipment, supplies and fixtures, operating properties used by subsidiaries for their operations, and operating a vehicle pool for business transportation.

Discussion

Category I: Depository Institutions

The Bank Service Corporation Act, 12 U.S.C. 1861-67, authorizes a bank service corporation, without prior approval, to perform the following services for depository institutions:

> check and deposit sorting and posting, computation and posting of interest and other credits and charges, preparation and mailing of checks, statements, notices, and similar items, or any other clerical, bookkeeping, accounting, statistical, or similar functions

12 U.S.C. 1863. All but one of the services listed above in Category I may be characterized as clerical, book-

keeping, or statistical in nature and would therefore be permissible.[1] Item 9 listed by bank counsel as "design, preparation and management of forms" is not a clerical, bookkeeping or statistical activity authorized by 12 U.S.C. 1863. However, this activity is a "correspondent service" which may be performed for other financial institutions under the rationale explained below in category II.

Category II: Other Financial Institutions

With prior approval of the appropriate federal regulator, a bank service corporation may engage in any activity (other than taking deposits) that would be permissible for all of the banks that own it. 12 U.S.C. 1864. Bank will be the sole shareholder of BSC, so the proposed activities will be permissible if they are permissible for a national bank. 12 U.S.C. 1864(a), (d).

National banks have traditionally performed services for one another. These "correspondent services" are necessary for the efficient functioning of the banking system. The Supreme Court has described correspondent services as follows:

> in neither law nor banking custom has there developed a clear, fixed definition of the correspondent relationship [but] among the services typically provided within a conventional correspondent arrangement are check clearing, help with bill collections, participation in large loans, legal advice, help in building securities portfolios, counseling as to personnel policies, staff training, help in site selection, auditing, and the provision of electronic data processing.

United States v. Citizens & Southern National Bank, 422 U.S. 86, 114-115 (1975). Such services "must be services that reflect and incorporate the unique nature of the banking business."[2] Four of the proposed services are permissible as correspondent services:

1. Forms

A national bank may design loan applications or disclosure statements for other banks, but may not design stationery or memo pads.[3] Since BSC has proposed to design, prepare, and manage forms for banking related items, this activity is permissible.

2. Mailroom Processing

The OCC has ruled that a national bank may provide mail sorting services in a banking related context.[4]

3. Bank Communication Support Services

BSC has proposed communications support services to other financial institutions, including use of an electronic network for transmission of visual, voice, and data communications. The OCC has permitted a national bank to establish a bank service corporation to operate an electronic funds transfer network, a system of data communications.[5] As noted in the OCC interpretive letter approving this activity, the purpose of the Bank Service Corporation Act is "to enable banks to make use of modern automated equipment by means of cooperative enterprises, in which the cost of expensive equipment is shared." The letter concludes that "while Congress could not anticipate the telecommunication features of modern data processing equipment, it clearly indicated that it did not intend to exclude or disapprove any particular kinds of equipment which technological innovation might produce." This rationale extends to BSC's proposal to establish an electronic network for visual and voice as well as data communications.

4. Courier Service

Several letters published by the OCC have permitted a national bank to operate a courier service shared by depository institutions for the purpose of picking up and delivering checks for collection and other documents related to banking.[6] The courier service that BSC

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[1] Item 8 in category I states that CNSC intends to use electronic data processing equipment to perform accounting services for other depository institutions. The OCC has ruled "that, in general, data processing is a technology rather than a service distinct or different from the underlying services or functions to which the technology is applied." *See* 12 CFR 7.3500. To the extent that CNSC's data processing equipment is used for a purpose which is clerical, bookkeeping, or statistical in nature, this service would be permitted under 12 U.S.C. 1863.

[2] *See* Interpretive Letter No. 137 (December 27, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,218.

[3] *See* Interpretive Letter No. 137 *supra* note 2.

[4] *See* Interpretive Letter No. 196 (May 18, 1981), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,277 (holding that bank may not invest in service corporation which sorts mail for an entity that is not a bank, and where the service is not offered in conjunction with other banking services).

[5] *See* Interpretive Letter No. 160 (1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,241.

[6] *See* Letter from Richard V. Fitzgerald, Director, Legal Advisory Services Division (May 22, 1981); Letter from Thomas G. DeShazo, Deputy Comptroller of the Currency (April 26, 1974).

has proposed [illegible] transmission of documents related to banking between financial institutions and therefore is also permissible.

Category III: Holding Company and Affiliates

These services, to be performed for bank and nonbank subsidiaries of Bank's holding company, consist of the following:

> Services for the internal operations, such as purchasing of equipment, supplies and fixtures, operating properties used by subsidiaries for their operations, and operating a vehicle pool for business transportation for subsidiary employees.

A national bank has authority to engage in activities that are incidental to the business of banking. 12 U.S.C. 24(Seventh). Allowing a bank holding company to consolidate servicing operations in a single entity permits all of the banks in the holding company to enjoy economies of scale in obtaining the services. Thus, on many occasions, the OCC has permitted national banks to perform for affiliates services that the bank could not necessarily provide to other entities.[7]

The proposed "services for the internal operations" have all been previously approved as services that a national bank may offer to its affiliates. Services for affiliates that have been approved in the past include:

- messenger services
- development, assembly, maintenance, and operation of computer equipment;
- security and guard services;
- operation of property for use as a parking lot;
- equipment purchasing; and
- vehicle pool services.

Since a national bank could provide the services to affiliates, a bank service corporation owned by a national bank may do so as well.

[7] Congress recognized that such services are "obviously incidental to the business of banking" when it enacted section 4(c)(1)(C) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(1)(C), which permits a bank holding company subsidiary to provide services to its affiliates. S. Rep. No. 1095, 84th Cong., 2d Sess. 2[illegible], *reprinted in* 1956 U.S. Code Cong. & Ad. News 2482, 2503.

You may, therefore, proceed with your proposal.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

514 — May 5, 1990

This is in response to the notification by The Chase Manhattan Bank, National Association (the "Bank") that it proposes to establish a *de novo* operating subsidiary and to expand the activities of an existing subsidiary, Chase Manhattan Capital Markets (Holdings) Inc. (collectively, "Subsidiaries"), as described below ("Proposal"). The summary set forth in this letter is based on the representations in the Bank's letters and in subsequent conversations between Frank Puleo, Bank Counsel, and Barrett Aldemeyer of the Office of the Comptroller of the Currency ("OCC").

The Bank's Proposal

One of the chief activities of the Subsidiaries will be the sale of debt obligations ("Bonds") collateralized by mortgage pools, consisting of pass-through mortgage-backed certificates guaranteed by the Government National Mortgage Association ("GNMA"), mortgage pass-through certificates issued by the Federal National Mortgage Association ("FNMA"), and mortgage pass-through certificates issued by the Federal Home Loan Mortgage Corporation ("FHLMC") (collectively, "Agency Pass-Through Certificates"). The Bonds will be issued either by the Subsidiaries or by other entities, including nonaffiliated financial institutions. The Bonds issued by the Subsidiaries may be issued directly by the Subsidiaries themselves or through trusts ("Owner Trusts") established by the Subsidiaries.

The Bonds, which will qualify for one of the two highest rating categories from an as yet undesignated nationally recognized rating organization, will be issued in series with periodic interest payment dates occurring monthly, quarterly, or semiannually. The series will be divided into classes, and principal payments will be made sequentially according to class. Each series of Bonds will be issued pursuant to an indenture with an independent trustee ("Indenture Trustee").[1] Each series will be collateralized by pools of GNMA, FNMA,

[1] *See* Maller, *The Collateralized Mortgage Obligation: The Latest Phase in the Evolution of Mortgage-Backed Securities*, 13 Real Estate Law Journal 299, 307-09 (1985); OCC Letter No. 388, n. 3 (June 16, 1987), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,612.

and or FHLMC pass-through certificates [2] Each series may be further secured by servicing agreements, reserve funds, and other credit enhancements (collectively, the collateral will be referred to as "Bond Collateral")

The Agency Pass-Through Certificates and other evidences of ownership interest in the underlying mortgages pools will be pledged to the Indenture Trustee. Record ownership of the Agency Pass-Through Certificates will be transferred to the Indenture Trustee to ensure that payments on the certificates and the underlying mortgages will be received directly by the Trustee. Upon receipt of the mortgage principal and interest payments, the Indenture Trustee will be authorized to reinvest these funds, and may also reinvest funds in debt service accounts and similar funds and accounts, in specified investments under the indenture. All such investments as well as the Agency Pass-Through Certificates themselves will qualify as eligible for underwriting and dealing by a national bank under 12 U.S.C. 24(Seventh) and 12 CFR Part 1.

Another activity to be conducted by the Subsidiaries through the agency of the Owner Trusts is the sale of undivided beneficial interests in the trust assets ("Trust Certificates"). The assets of the Owner Trusts consist of the pools of Agency Pass-Through Certificates as well as the reserve funds, principal, and interest payments and other similar funds collateralizing each series of Bonds issued by the Trusts. The ownership interest of the holders of the Trust Certificates will be subject to the prior rights of the owners of the Bonds ("Bondholders"). As a result, the relevant Indenture Trust will subject the trust assets and all proceeds from any conversion of such assets to a first priority perfected security interest in favor of the Indenture Trustee on behalf of the Bondholders. The owners of the Trust Certificates will not be able to alter the trust assets, except for the limited right to substitute Agency Pass-Through Certificates.

The Owner Trustees will perform various administrative functions, including the payment of the expenses of the Owner Trusts out of available trust funds and the preparation and filing of periodic reports. In general, the Owner Trustees will administer the Owner Trusts for the benefit of the Trusts' beneficial owners. If the Owner Trusts issue Trust Certificates representing beneficial interests in the Trusts, the Owner Trustees will supervise and record transfers of interests in the Trust Certificates and remit payments to the holders of the certificates.

Both the Indenture Trustee and the Owner Trustees will be authorized and will be obligated if so directed by the requisite number of Bondholders or holders of Trust Certificates, respectively to pursue remedies on behalf of the Bondholders and certificateholders in the event of lapses in fund collection or default including the remedy of seeking payments from the appropriate guarantor of the Agency Pass-Through Certificates Public issuances of the Bonds will be subject to the Trust Indenture Act which would require the Indenture Trustee to seek payments from the appropriate guarantor of the Agency Pass-Through Certificates on behalf of the Bondholders

Recourse on the Bonds will be limited to the Agency Pass-Through Certificates and other Bond Collateral which is expressly pledged to secure the Bonds Recourse on the Trust Certificates will be limited to the assets of the Owner Trusts which issued the certificates. In no case will recourse on the Bonds or the Trust Certificates extend to the Bank.

A registration statement under the Securities Act of 1933 will be filed for public issuances of the Bonds. An exemption might be available under section 4(2) of the Securities Act of 1933 for the Trust Certificates, which will be privately placed.

You anticipate that the activities of the Subsidiaries will be exempt from the Investment Company Act under section 3(c)(5(C) because of the safe-harbor established in various no-action letters of the Securities and Exchange Commission for collateral consisting of at least 55 percent whole pool Agency Pass-Through Certificates. For any proposal by the Subsidiaries not within section 3(c)(5)(C), an exemption would be obtained under section 6(c) of the Investment Company Act.

You maintain that the Subsidiaries will not be required to maintain reserves under Regulation D of the Board of Governors of the Federal Reserve System, 12 CFR Part 204, by reason of the contemplated activities because no "deposit" will exist for purposes of Regulation D *See* 12 CFR 204.2(a)(2)(ix). In addition, the maturity of the obligations to be issued will be longer than a year and one-half, which would mean that the applicable reserve percentage under 12 C.F R. 204 9 would be zero, even if a "deposit" were found to be present You indicate, furthermore, that the "affiliate paper" test in 12 CFR 204.2(a)(1)(v) will not be triggered because the Bank will never receive principal or interest payments from the Agency Pass-Through Certificates You have also represented that, under generally accepted accounting principles, regulatory accounting principles and for other bank regulatory purposes, some of the issuances of the Subsidiaries may be accounted for as a

[2] The collateral will also include principal and interest payments received on the pass-through certificates as well as income received from the investment of these payments (see discussion in following paragraph)

sale of assets while others may be treated as a borrowing [illegible] by those assets.

Legal Analysis

For the reasons discussed below, we find the Bank's proposal to be legally permissible.

Authority under Banking Statutes

The corporate powers provisions of 12 U.S.C. 24 (Seventh), in language unchanged since their enactment in 1864, specifically authorize national banks:

> To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt.

The right to discount and negotiate includes both the right to buy and to dispose of evidences of debt. *See, e.g., Danforth v. National State Bank of Elizabeth*, 48 F. 271 (3rd Cir. 1891); *Newport National Bank v. Board of Education of Newport*, 114 Ky. 87, 70 S.W. 86 (1902); *Morris v. Third National Bank of Springfield*, 142 F. 25 (8th Cir. 1905), *cert. denied*, 201 U.S. 649 (1906). The activities of the Subsidiaries in the current proposal fall within this statutory authorization.[3] The Subsidiaries will sell "evidences of debt" within the meaning of the statute (collateralized debt obligations). To accomplish these sales, the Subsidiaries will purchase Agency Pass-Through Certificates and will issue mortgage obligations collateralized by these certificates. The Subsidiaries may also sell residual interests in the debt collateral (Trusts Certificates) as part of the sale of debt obligations. In addition, the Subsidiaries may simply purchase the collateralized mortgage obligations directly from another issuer. These combined activities are a part of the statutorily permissible purchase and sale of debt obligations. *See First National Bank of Hartford v. City of Hartford*, 273 U.S. 548, 559-60 (1927) (national banks can sell real estate mortgages and other evidences of debt in the exercise of a national bank's express statutory authority to make real estate loans and to discount and negotiate other evidences of debt).

National banks are also authorized, under 12 U.S.C. 371(a), to

> make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation.

The OCC's implementing regulation, 12 CFR Part 34, imposes no limitations on the sale of real estate loans or interests therein. Indeed, the purchase and sale of interests in loans (commonly referred to as loan participations) is a traditional banking activity. *See* OCC Banking Circular 181 (August 2, 1984). Furthermore, it is well established that the sale of real estate loans can be accomplished through the issuance of mortgage-backed participations and debt instruments. Over the past decade, the OCC has approved a number of transactions which, like the present Bank Proposal, involved the sale of mortgage-backed or mortgage-related obligations. *See, e.g.*, OCC Press Release and Letter of March 30, 1977, *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 97,093; OCC Letter No. 92 (April 20, 1979), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,167; OCC Letter No. 132 (February 1, 1980), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,213; OCC Letter No. 251 (September 17, 1982), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,415; OCC Letter No. 257 (April 12, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,421; OCC Letter No. 362 (May 22, 1986), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,532; OCC Letter No. 388, *supra*.

Authority under the Glass-Steagall Act

1. Glass-Steagall not applicable

Because the activities of the Bank and the Subsidiaries in creating and marketing the mortgage-backed obligations and the Trust Certificates are permissible exercises of the Bank's statutory authority under 12 U.S.C. 24 (Seventh) and 371(a), the Glass Steagall Act does not restrict them. *See, e.g., Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 137, 158 n. 11 (1984)("Bankers Trust I") (Glass-Steagall prohibitions do not affect the permissibility of activities which are part of the business of banking); *Securities Industry Association v. Clarke*, 703 F. Supp. 256 (S.D.N.Y. 1988), *rev'd* 885 F.2d 1034 (2d Cir. 1989), *cert. denied*, ___ U.S. ___ (February 20, 1990) (the offering of mortgage pass-through certificates by a bank is part of the business of banking and is not affected by Glass-Steagall's prohibitions on underwriting). Section 16 of Glass-Steagall reenacted the corporate powers provisions of 12 U.S.C. 24

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[3] Other provisions of 12 U.S.C. 24 (Seventh) which deal with bank underwriting and dealing in mortgage-backed debt instruments issued or guaranteed by GNMA, FNMA, or FHLMC also authorize the proposed activities. Furthermore, section 21 of the Glass-Steagall Act, 12 U.S.C. 378, specifically exempts from its coverage the authority of national banks to [illegible] evidencing interests in real estate. These [illegible] provisions will be discussed *infra*.

(Seventh). There is no indication in the statutory language or the legislative history that Congress intended to limit or remove expressly authorized banking powers. The purpose of the act was instead to limit banks' participation in the securities business. Therefore, the Proposal is not subject to the restrictions of the act, and the Bonds and Trust Certificates are not Glass-Steagall securities.

Even apart from this point, the activities of the Subsidiaries are permissible under the Glass-Steagall Act.[4]

2. Bonds

a. Statutory Permission under Glass-Steagall

i. Section 16 of Glass-Steagall

The proposed activities in creating and marketing the Bonds are specifically authorized under the Glass-Steagall Act. Section 16 of the act provides:

> The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to . . . obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association, or mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act.

12 U.S.C. 24 (Seventh). The Bonds will be backed solely by obligations of FNMA, GNMA, or FHLMC which meet the above-stated statutory requirements. If these FNMA, GNMA, and FHLMC obligations, which we have referred to herein as Agency Pass-Through Certificates, were purchased by the Bank or the Subsidiaries and sold directly to the public, there is no question that these activities would be permissible under the statute.

Similarly, in my opinion, the sale of Bonds collateralized by these same Agency Pass-Through Certificates qualifies for the statutory permission set forth in section 24 (Seventh). The Bonds convey to the Bondholders the same essential rights and obligations which are possessed by holders of the Agency Pass-Through Certificates. Thus, the Bonds share the essential legal characteristics of the Agency Pass-Through Certificates, and the statutory permission to underwrite and deal in these certificates extends to the Bonds as well. *See* interpretive letters, *supra*, especially letters no. 257 and 362.

ii. Section 21 of Glass-Steagall

Since the proposed creation and marketing of the Bonds are permissible under section 16 of the Glass-Steagall Act, the restrictions of section 21 of the act are not applicable. Section 21, codified at 12 U.S.C. 378, prohibits organizations "engaged in the business of issuing, underwriting, selling, or distributing . . . securities" from engaging "in the business of receiving deposits . . ." There are two limitations on the prohibitions of section 21. First, the prohibitions do not impair the ability of banks to sell investment securities or to issue securities "to the extent permitted to national banking associations by the provisions of section 24 of this title. . ." As interpreted by the D.C. Circuit in *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052, 1056-58 (D.C. Cir. 1986), *cert. denied*, 107 S.Ct. 3228 (1987) ("*Bankers Trust II*"), this means that activities permissible under section 16 cannot be prohibited by section 21. The court would not even address the meaning of the terms in section 21 unless it was determined that section 16 did not provide an answer. *Id.* at 1057. *See also Board of Governors of the Federal Reserve System v. Investment Company Institute*, 450 U.S. 46, 62-63 (1981) (section 21 does not require banks to abandon banking practices authorized by section 16); *cited with approval in Securities Industry Association v. Clarke*, 885 F.2d at 1034.

The second proviso in section 21 states that its restrictions will not affect the rights which "any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate . . ." The legislative history of the provision reflects a congressional interest in promoting the secondary mortgage market. *See* Letter from Robert L. Clarke, Comptroller of the Currency, to Senator Alfonso M. D'Amato, dated June 18, 1986. Since national banks are empowered under 12 U.S.C. 24 (Seventh) and 371(a) to sell debt obligations evidencing interests in real estate, section 21 does not apply to the activities of the Subsidiaries and the Trusts which consist in es-

[4] In *Bankers Trust I*, the U.S. Supreme Court held that commercial paper was a security for purposes of the Glass-Steagall Act. The Court found no specific permission in the Glass-Steagall Act or in other statutes for banks to underwrite these short-term financial instruments. 468 U.S. at 149-54. In contrast, in the present case, the Bank (and its Subsidiaries) have authority under provisions of national banking law to sell obligations secured by real estate loans. 12 U.S.C. 371(a). In addition, under section 16 of the Glass-Steagall Act, the Bank has specific authority to market Agency Pass-Through Certificates, and under section 21 of the Act, Bank sale of obligations evidencing interests in real estate is exempted from Glass-Steagall restrictions. 12 U.S.C. 24 (Seventh) and 378(a)(1).

[illegible] in the secondary market of Bonds [illegible] by interests in real estate loans.[5]

2. Avoidance of Glass-Steagall Hazards

One of the chief objectives of the Glass-Steagall Act was to separate commercial banks from some of the risks or hazards associated with investment banking. *See Investment Co. Institute v. Camp*, 401 U.S. 617, 630 (1971)("*Camp*"). In *Camp*, the Supreme Court identified the hazards associated with investment banking. The most obvious hazard was that the banks might place their funds in bad investments which could lead to the loss of those funds. 401 U.S. at 630. Other "more subtle hazards" involved promotional and other pressures to which the bank might yield. *Id.* at 630-34. To avoid these hazards, Congress enacted various prohibitions, one of which was the prohibition in section 16 of the act against bank underwriting and dealing in certain securities.

However, since the passage of the act in 1933, numerous statutory exceptions to the general underwriting and dealing prohibitions have been granted. For example, commencing in 1938, Congress has enacted a series of permissions for bank underwriting and dealing in obligations of various national mortgage associations, including FNMA (1954), GNMA (1968), and FHLMC (1974). *See* National Housing Act Amendments of 1938, Pub. L. 424, ch.13, section 13, 52 Stat. 26 (1938); Housing Act of 1954, Pub. L. 560, ch. 649, title II, 203, 68 Stat. 622 (1954), Housing and Urban Development Act of 1968, Pub. L. 90-448, title VIII, 807j, 82 Stat. 545 (1968); Housing and Community Development Act of 1974, Pub. L. 93-383, title VIII, 805(c)(1), 88 Stat. 726. The congressional purposes in enacting these permissions for bank underwriting and dealing in securities issued or guaranteed by mortgage associations have been chiefly to provide a degree of liquidity to the secondary market for home mortgages and to promote the production and sale of housing by encouraging the participation of private enterprises in the financing of the housing market. *See* Housing Act of 1954, Pub. L. 560, ch. 649, title II, section 201, 68 Stat. 612 (1954), H.R.Rep. No. 1585, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. Code Cong. & Ad. News 2873-74, 2943-48. By permitting banks to underwrite and deal in these securities, Congress has, in effect, performed a Glass-Steagall hazards analysis and determined that the limited risks associated with the distribution of these mortgage-related obligations are outweighed by the increased marketability of the obligations and improved opportunities for home financing.

The same hazards analysis that applies to GNMA, FNMA, and FHLMC securities (Agency Pass-Through Certificates) applies to the issuance and sale of Bonds secured by these Agency Pass-Through Certificates. The Bonds will preserve and enhance the marketability of the Agency Pass-Through Certificates by providing a convenient investment vehicle with a regular payment structure and increased investment security derived from the more diversified portfolio of pooled certificates. The marketing of the Bonds will also undoubtedly expand the opportunities for providers of home mortgages to resell their loans in the secondary market and thus will improve the opportunities for direct mortgage financing. Therefore, the sale of Bonds secured by the Agency Pass-Through Certificates, whether these Bonds are issued by the Bank or another entity, promotes the same goals which led Congress to permit banks to underwrite and deal in the Agency Pass-Through Certificates themselves. Furthermore, the risks associated with the sale of these Bonds are not materially different from the risks associated with the sale and distribution of Agency Pass-Through Certificates, because, as noted frequently in this discussion, the legal characteristics of the certificates flow through to the Bonds and the Bondholders. Therefore, the congressional objectives in permitting bank underwriting and dealing in Agency Pass-Through Certificates as an exception to the prohibitions of section 16 are also met by the sale of Bonds secured by those certificates.

3. Trust Certificates

The prior discussion indicates that the issuance and sale of the Bonds are permissible under the Glass-Steagall Act. The issuance and sale of the Trust Certificates are also permissible because the private placement of these certificates is not "underwriting" or "dealing" for Glass-Steagall purposes.

Because the sale of the Trust Certificates will be conducted in the manner of a private placement, the offering will not involve Glass-Steagall underwriting or distribution activities.[6] The D.C. Circuit Court of Appeals

[5][illegible] and sale of Trust Certificates is also not restricted by section 21 for the same reasons that apply to the [illegible] of Bonds.

[6]The OCC, as well as the Federal Reserve Board, has also long maintained that bank private placement activities are legally permissible. *See* OCC Letter No. 32 (December 9, 1977), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,107; Federal Reserve Board Staff Study, Commercial Bank Private Placement Activities (1977). The private placement of certificates for undivided shares in bank-issued mortgage pools has also been held to be permissible. OCC Letter No. 25 (February 14, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,100; OCC Letter No. 41 (May 18, 1978), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 85,116; OCC Letter No. 57 (May 29, 1981), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 87,275. Thus, the private placement activities in the current proposal are within the range of activities approved in OCC precedent.

recently held that a commercial bank's private placement of a Glass-Steagall security (commercial paper) did not constitute underwriting for purposes of the act. *Bankers Trust II*, 807 F.2d at 1062. The court found that the exclusion of bank private placement activities from Glass-Steagall "underwriting" and "distribution" was consistent with the purposes of the act and did not raise the "subtle hazards" associated with an impermissible incursion into the realm of investment banking. *Bankers Trust II*, 807 F.2d at 1062-67. The private placement activity of the Owner Trusts, like that in *Bankers Trust II*, will involve marketing certificates only in large denominations to a limited number of institutional investors and with limited advertising. *See Bankers Trust II*, 807 F.2d at 1064. Thus, the subtle hazards will not be present in the Proposal.

Furthermore, in investment banking, the terms "underwriting" and "dealing" are generally limited to activities undertaken by an intermediary on behalf of an issuer of securities. Underwriting is commonly understood as the process of facilitating the distribution of newly issued securities to investors by purchasing them from the issuer and coordinating or conducting the sale and distribution of the securities. *See* Jennings and Marsh, Securities Regulation (5th ed. 1982), 15-16. Dealing similarly involves buying and selling the securities of others. The sale of the Trust Certificates, on the other hand, does not involve Bank intermediation for another issuer. Instead, the Bank itself, through the vehicle of the Owner Trusts, will issue the certificates, representing beneficial interests in the assets of the Trusts.[7] Such activity does not constitute "underwriting" or "dealing" within the meaning of section 16. *See* OCC Letter No. 388, *supra*.

III. Conclusion

The activities which the Bank plans to conduct through its Subsidiaries, as set forth in the Proposal, are, therefore, legally permissible.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

[7]The Trusts are merely vehicles for the packaging and sale of the Agency Pass-Through Certificates. The assets of the Trusts consist almost exclusively of Bank-purchased pass-through certificates or income derived from those certificates. Therefore, for Glass-Steagall purposes, the Trusts are considered legally transparent rather than entities distinct from the Bank. *See* OCC Letter No. 257, *supra*.

515 — July 9, 1990

This is in response to a notification pursuant to 12 CFR 5.34 by Citibank, N.A. ("the Bank") that the Bank intends to perform new activities through an existing operating subsidiary, AMBAC, Inc., and its subsidiary AMBAC Indemnity Corporation (collectively "the Subsidiary").[1] As discussed below, we find that the proposed activities are permissible pursuant to 12 U.S.C. 24(Seventh).

The Subsidiary presently engages in the issuance of standby credits for municipal bonds in the form of municipal bond insurance. The OCC determined that this activity is a traditional banking practice permissible under 12 U.S.C. 24(Seventh). OCC Interpretive Letter No. 338, *reprinted in* Fed. Banking L. Rep. (CCH) [1985-1987 Transfer Binder] ¶ 85,508 (May 2, 1985). The D.C. Circuit Court concurred in this reasoning. *American Insurance Association v. Clarke*, 854 F.2d 1405 (D.C. Cir. 1988), *withdrawn and rereported on rehearing*, 865 F.2d 278 (D.C. Cir. 1989). In connection with the issuance of municipal bond insurance, the Subsidiary presently performs investment research.

In your notification, you state that Subsidiary proposes to broaden its activities and act as a co-investment adviser to a closed-end municipal fund. In this capacity, the Subsidiary will provide investment research including identifying bonds for fund purchase, monitoring the risks of the municipal bond market and the credit risk of bonds in the fund's portfolio, and identifying trading opportunities. The Subsidiary will register as an investment adviser under the Investment Advisers Act of 1940.

The fund will be sponsored by Equitable Capital Corporation ("the Sponsor"), which will also act as co-investment adviser and administrator to the fund. In its capacity as investment adviser, the Sponsor will perform such functions as portfolio balancing, structuring and diversification, managing assets and liabilities, and trading and execution. Custodian, transfer agent, and shareholder servicing functions will be performed by third parties recommended by the Sponsor and the Subsidiary and approved by the trustees of the fund. The distribution function will be performed by third party underwriters and broker-dealers.

On a number of occasions, the OCC has determined that the provision of investment advice is a permissible

[1]Our understanding is that the Subsidiary was originally known as American Municipal Bond Assurance Corporation.

activity for national banks and their operating subsidiaries. *See, e.g.*, OCC Interpretive Letter No. 403, reprinted in Fed. Banking L. Rep. (CCH) ¶ 85,627 (December 9, 1987). *Decision of the Comptroller of the Currency Concerning an Application by American National Bank of Austin, Texas, to Establish an Operating Subsidiary to Provide Investment Advice* (September 2, 1983), *reprinted in* Fed. Banking L. Rep. (CCH) ¶ 99,732, *suit filed, Securities Industry Association v. Conover*, No. 83.3581 (D.D.C. November 30, 1983), *dismissed with prejudice* (January 20, 1988).

Accordingly, you may proceed with your proposal.

Stephen R. Steinbrink
Deputy Comptroller for
Multinational Banking

* * *

516 — July 12, 1990

This letter is in response to your notification that Citibank ("Bank") proposes to establish a wholly owned operating subsidiary to participate, as a general partner, in a joint venture to engage in certain information analysis and execution services with respect to various securities. The joint venture will consist of the Bank's operating subsidiary and four other general partners, each of which is a subsidiary or an affiliate of an investment bank. The Bank's operating subsidiary will have a 17 percent interest in the partnership.

The partnership, as your letter states, "will provide the following services with respect to all types of securities: (1) Databases. Obtain, compile, and distribute an electronic database of information concerning financial instruments, domestic and international financial markets, economic information, and news; (2) Software and Hardware. Create, lease, and license to third persons (including the partners of the partnership and their affiliates), communications system(s), computers, analytic software, and related equipment and services which enable the partnership to transmit such information to subscribers and allow subscribers to analyze such information; and (3) Communication and Execution Services. Provide communication channels whereby each partner in its individual capacity and its affiliates may provide information, analytics, and other services (including electronic execution services) to third parties of its choosing."

The customers of the partnership will be primarily affiliates of the partners, financial institutions, and other corporations. For the reasons given below, you may proceed with your proposal subject to the conditions specified in this decision.

The proposed information analysis and execution services relating to securities are incidental to or part of the business of banking within the meaning of 12 U.S.C. 24(Seventh). You indicate that the information that the partnership will provide to customers is information generated or acquired for the Bank's and its affiliates' own use. Examples of the databases include current and historical price data for U.S. Treasury securities, foreign government securities, foreign exchange, corporate debt, and asset-backed securities. In each instance the Bank and its affiliates play significant roles as underwriters, dealers, investors, or issuers with regard to these types of obligations. Even if this were not the case, such economic information gathering, analysis and furnishing to customers would be permissible as part of the Bank's investment advisory or financial advisory services.

The creation and marketing of software as part of a data processing package is also permissible. *See, e.g.*, the OCC's data processing ruling, 12 CFR 7.3500:

> It is the opinion of the Comptroller that, in general, data processing is a technology rather than a service distinct or different from the underlying services or functions to which the technology is applied. A national bank may use data processing equipment and technology to perform for itself and others all services expressly or incidentally authorized under the statutes applicable to national banks.

See also Interpretive Letter No. 346, July 31, 1985, Fed. Banking L. Rep. (CCH) para. 85,516 (authorizing a national bank operating subsidiary to provide electronic information and transactional services in connection with commodity transactions).

With respect to the hardware, although it can be used for purposes beyond the provision of the financial and economic data involved in your proposal, the hardware is described as a necessary, convenient, and useful incident to the electronic data services being furnished. On this point, *see, e.g.*, Interpretive Letter No. 345, July 9, 1985, Fed. Banking L. Rep. (CCH) para. 85,515 (approval for an operating subsidiary to sell computer hardware as part of a package of banking and financial data processing services where the hardware was only a small part of the value of the total package). That letter points out that the sale of general purpose hardware as part of a data processing package could be considered incidental or subordinate to the package if the cost of the hardware does not exceed 30 percent of the total cost of the package.

referencing 12 CFR 225.25(b)(7)(iii) by way of analogy You have indicated that the cost of the hardware involved in your proposal will not exceed this 30 percent maximum.

Finally, the communications channels will allow the Bank's operating subsidiary and its partners to match buyers and sellers electronically. The transactional capability is a way to allow subscribers to list their offers to sell and bids to buy specific securities or other financial instruments on the computer system and to provide buyers and sellers a means to communicate with each other without the need to go off the system. This is consistent with a national bank's finder role covered in Interpretive Ruling 7.7200, 12 CFR 7.7200. *See also* Interpretive Letter No. 346, *supra* (electronic bringing together of buyers and sellers in connection with commodities transactions).

The partnership structure poses no problems provided certain conditions are met. It is well established that a national bank's operating subsidiary may be a general partner with one or more other general partners, *see, e.g.*, Interpretive Letter No. 419, Feb. 16, 1988, Fed. Banking L. Rep. (CCH) para. 85,643; Interpretive Letter No. 289, May 15, 1984, Fed. Banking L. Rep. (CCH) para. 85,453, so long as the partnership will engage only in activities that are permissible for a national bank. As discussed above, the proposed activities are permissible.

Moreover, the following protections are built into the partnership: (1) Each general partner will have one representative to serve on the management board of the partnership. (2) Partnership decisions to select the initial chief executive officer, to add an additional partner to the partnership, to change the business purpose of the partnership or otherwise amend the partnership agreement, require the vote of 100 percent of the partnership interests, effectively giving the Bank's operating subsidiary a veto power over these decisions. (3) The total commitment by the Bank and its affiliates to the partnership, including contributions and extensions of credit to the partnership, will not exceed 5 percent of the Bank's primary capital. (4) The operating subsidiary will exercise its veto over any partnership decision to change the business purpose of the partnership if any proposed activity would be impermissible for national banks.

Approval of your operating subsidiary notification is also subject to two additional conditions. First, the partnership will be subject to supervision and examination by the OCC. This condition is imposed on all partnership ventures entered into by national banks and their operating subsidiaries. This condition must be understood and accepted by all the partners.

Second, the operating subsidiary regulation, 12 CFR 5.34, requires notification to the OCC if a bank intends to perform "new activities" in an existing operating subsidiary. Accordingly, if the partnership at some future time decides to engage in new activities, i.e. activities not covered by your current notice and our response thereto, then the Bank must submit a notice to us pursuant to 12 CFR 5.34. This submission must be made even though the new activities have been found to be permissible for national banks.

Because the other general partners are subsidiaries or affiliates of investment banks, we have considered whether the proposed partnership would be prohibited by sections 20 or 32 of the Glass-Steagall Act. Section 20 (12 U.S.C. 377) provides that a member bank cannot be affiliated in any manner described in 12 U.S.C. 221a with a business organization engaged principally in the issue, flotation, underwriting, public sale, or distribution of securities. Assuming *arguendo* that the parent investment banking firms are engaged principally in the described securities activities, nevertheless there is no prohibited affiliation caused by virtue of the partnership venture outlined in your proposal. None of the four tests for affiliate status in 12 U.S.C. 221a is met. Neither the Bank nor its parent holding company will, as a result of the partnership, own or control a majority of any of the investment banks' shares or control the election of a majority of any of the investment banks' directors. *See* 12 U.S.C. 221a(b)(1) and (2). Nor will any of the investment banks have directors who will be directors of the Bank, or own or control a majority of the Bank's shares or control in any manner the election of a majority of the Bank's directors. 12 U.S.C. 221a(b)(3) and (4). In sum, the proposed partnership will not cause the Bank to become affiliated with any of the investment banks in any manner described in 12 U.S.C. 221a.

The partnership proposal also will not result in a prohibited employee interlock between the Bank and the investment banks. Section 32 of the Glass-Steagall Act, 12 U.S.C. 78, provides that no officer, director or employee of any business organization primarily engaged in the issue, flotation, underwriting, public sale or distribution of securities shall serve at the same time as an officer, director, or employee of a member bank. No bank officer, director, or employee will serve as such in any of the investment banks, and no investment bank officer, director, or employee will serve as such in the Bank. As explained in detail in Interpretive Letter No. 411, Jan. 20, 1988, Fed. Banking L. Rep. (CCH) para. 85,635 (national bank operating subsidiary in partnership with an affiliate of an investment bank, with the partnership enterprise making bridge loans), a partnership's management and staff are not ordinarily attr

made to the current name of the business entities involved.

Subject to the conditions specified in your notification letter and this response, you may proceed with the proposal.

J. Michael Shepherd
Senior Deputy Comptroller
for Corporate and Economic Programs

* * *

517 — August 16, 1990

In your letter of March 28, 1990, you notified the Office of the Comptroller of the Currency ("OCC") of Citibank, N.A.'s ("Bank") proposal to modify the structure and activities of an existing operating subsidiary. The Bank had been authorized to establish the subsidiary to enter into a partnership with an affiliate of an investment bank. The partnership engaged in the activity of making short-term commercial loans to finance leveraged buyouts and recapitalizations. OCC Interpretative Letter No. 411, [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,635 (January 20, 1988).

For a variety of reasons, the Bank had suspended the activities of that partnership and now proposes to enter into two other partnerships that will also engage in making commercial loans in connection with highly leveraged transactions (leveraged buyouts and recapitalizations). The new partnerships, which are limited partnerships, however, will involve a different general partner and will be structured differently. In addition, there are differences in funding, allocation of returns, and other factors with respect to the lending activities. For this reason, we had considered your letter a notification, pursuant to 12 CFR 5.34, of new activities in an existing operating subsidiary. As a result of subsequent developments, you have indicated verbally that this notification now should be treated as one to establish a de novo wholly owned operating subsidiary ("Subsidiary") in which to conduct the proposed activities.

Based on the information, facts, and representations provided in your letter, attachments and supplemental materials submitted subsequently, and through conversations with Madonna Starr of the Legal Advisory Services Division, the OCC has no objection to the Bank's establishing an operating subsidiary to conduct the activities described in the Bank's proposal.

Partnership Structure

The Subsidiary and nondepository subsidiary of Dillon, Read, a different investment bank ("Investment Bank") will be general partners and limited partners of two tandem limited partnerships which will carry on the activities of the Citicorp Mezzanine Fund ("Fund").[1] One limited partnership, the Subordinated Debt Partnership in which the Subsidiary is general partner and the Investment Bank is a limited partner, will make medium-term commercial loans. The second limited partnership, the Equity Partnership in which the Investment Bank is general partner and the Subsidiary is a limited partner, will hold any "equity kickers," in the form of stock warrants, that are received in connection with such loans. All other limited partners, including the Investment Bank's parent company, will be limited partners of both limited partnerships that jointly operate the Fund.

The Bank's financial commitment, through the Subsidiary, to the Fund will be $110 million, an approximately 17 percent interest in the limited partnerships. The other general partner and the limited partners will contribute a total of $527 million to the Fund. The other general partner's interest will be approximately 1.5 percent including a $10 million capital contribution made by the parent company of the Investment Bank and consolidated with the Investment Bank's contribution. The limited partnership interests were sold in 1989, when the Fund was proposed, in a private placement to sophisticated financial institutions.

Capital committed to the Fund by the limited partner investors will be available for loans by the Fund. Profits and losses to the Fund will be allocated among the partners on an aggregate rather than transaction-by-transaction basis. All net cumulative profits of the partnerships, including both current income and capital gains associated with the stock warrants, will be allocated to all partners pro rata according to capital contributions until all have received a preferential return. The preferential return is a net cumulative profit allocation, set by specifying a number of basis points over the 10-year Treasury rate. All net cumulative profits in excess of this preferential rate will be allocated 80 percent to all investors pro rata according to capital contribution. The remaining 20 percent, a form of management incentive fee referred to as the "carried interest," is divided by the general partners, 19 percent to the Subsidiary and 1 percent to the Investment Bank.

[1]The Citicorp Mezzanine Fund is not a legal entity. Rather, it is a trade name used to describe the two limited partnerships that jointly operate the Fund.

Losses are to be netted againset profits. Accordingly, all net cumulative losses to the Fund will be allocated first to the Subsidiary in an aggregate amount not to exceed 10 percent of the Fund's original capital commitments, i.e., $63.7 million. Any net cumulative losses thereafter will be allocated to all investors pro rata according to capital accounts. This agreement does not represent a guarantee of the partnerships' performance but is simply a loss allocation device.

Pursuant to a formal investment adviser agreement, the Bank will be the investment adviser to the Fund. All Fund investment decisions will be made by an investment committee, the majority of the members of which shall be officers of the Bank. The Subsidiary will maintain significant credit controls over the activities of the Fund, by means of conducting a thorough independent credit review of each proposed transaction and of exercising its veto authority over investment/credit decisions. Under the terms of the partnership agreements, the Investment Bank will also have veto authority over these decisions. In addition, the Subsidiary will have veto authority over the disposition of the partnerships' assets.

The limited partnership agreements expressly provide that the partnerships cannot perform activities unless they are permissible for a national bank and its operating subsidiary, and that the limited partnerships are subject to the regulation, supervision and examination of the OCC.

Partnership Activities

The Fund's limited partnerships will be formed for the purpose of making commercial loans and receiving equity participations, typically warrants but possibly stock appreciation rights and net profit participation rights, in leveraged buyouts and recapitalizations in the United States, Europe, Canada, and Australia. The commercial loans will be both secured and unsecured, will typically contain subordination terms, and will typically be medium-term. Under certain circumstances, the Fund may also make bridge loans. As the Fund makes a loan to a borrower, the loan will be funded by the capital contributions of the general and limited partners, each loan made pro rata on the basis of each partners' capital commitment to the Fund.

The limited partnership agreements also provide that "substantially all" of the loans made shall be in transactions "sponsored" by entities affiliated with the Bank's parent holding company. For example, an affiliate of the Bank, a small business investment company ("SBIC"), will be a major equity investor in substantially all the Fund's portfolio companies. The Fund will have a "right of first refusal" to make the mezzanine loan in substantially all of the leveraged buyouts in the United States in which this SBIC makes a significant equity investment. Additionally, it is anticipated that the Fund will have an opportunity to invest in similar transactions of the Bank's affiliates in Europe, Canada, and Australia.

The Bank, as the Fund's investment adviser, will provide advisory, management, administrative, and support services to the Fund. Without limitation, the Bank will (1) identify and evaluate potential borrowers; (2) structure and negotiate potential loans; (3) make a credit recommendation to the Fund concerning a potential loan; (4) monitor and report upon the performance of the Fund's loans, and (5) propose "exit strategies" to the general partners concerning the disposition of Fund assets. All investment decisions will conform to the credit analysis procedures and disciplines of the Bank's "Risk Asset Process." Each investment decision must be approved by a member of the Bank's Credit Policy Committee.

Loans made by the Fund will conform to guidelines established by the Bank that describe the target return for the Fund, the current yield, and a leverage ratio (defined as the ratio of subordinated debt to securities junior in preference to the subordinated debt) to determine the level of equity participations (warrants to purchase) eligible to be received in connection with each loan. An aggregate to 10 percent of total committed capital, however, may be utilized for loans that do not conform to these guidelines. To increase the overall return, the Fund may choose not to provide all of the mezzanine financing or may arrange for others to fund all or a portion of a financing commitment.

The Fund will not provide financing for a hostile tender offer nor will the Fund provide bridge loans except those related to Fund commitments. No more than 25 percent of the Fund's committed capital will be loaned to a single portfolio company.

Finally, the Bank has indicated that it will comply with the two lending and investment limitations set forth in OCC Interpretative Letter No. 411, *supra*. First, the total commitment of the Bank, the Subsidiary, and other Bank affiliates to the tandem limited partnerships that operate the Fund, including partnership contributions, investments, and loans and other extensions of credit (both direct and indirect), shall not in any event exceed five (5) percent of the Bank's primary capital. Second, with respect to the Subsidiary, the aggregate amount of the Bank's investment and extensions of credit (both direct and indirect) may not exceed an amount equal to the Bank's legal lending limit, i.e., fifteen (15) percent of the Bank's capital and surplus, at the time of the investment or loan of any funds.

Discussion

As stated in OCC Interpretive Letter No. 411, *supra*, the Bank may conduct activities through an operating subsidiary that are a part of or incidental to the business of banking. 12 CFR 5.34(c) and (d). The activities to be conducted by the Subsidiary through the Fund operated by the tandem partnerships are permissible banking activities. The making of commercial loans by the Subordinated Debt Partnership to finance highly leveraged transactions is a lending activity that falls squarely within a national bank's express lending authority under 12 U.S.C. 24(Seventh).

As an incidental activity, the OCC has permitted national banks, in negotiating loan agreements, to accept stock warrants in addition to or in lieu of interest on loans. The receiving and holding of such "equity kickers" is permitted by OCC Interpretive Ruling 7.7312, 12 CFR 7.7312, which provides that:

> [a] national bank may take as consideration for a loan a share in the profit, income or earnings from a business enterprise of a borrower. Such share may be in addition to or in lieu of interest. The borrower's obligation to repay principal, however, shall not be conditioned upon the profit, income or earnings of the business enterprise.

While the receiving and holding of stock warrants is permitted in connection with making a loan, however, this incidental power does not authorize a national bank to exercise such warrants. The exercise of such warrants would result in a "purchase" of stock in violation of 12 U.S.C. 24(Seventh). Under the Bank's proposal, the Equity Partnership would merely receive and hold the stock warrants, a legally permissible activity.

The OCC has permitted an operating subsidiary to be a general partner or a limited partner in a limited partnership with a nondepository institution formed to engage in activities that are permissible for a national bank, provided certain conditions are met. While some features of the proposed limited partnerships are not identical to those of partnerships approved previously, e.g., the general partnership interests of the Subsidiary and the Investment Bank are proportionately lower, they are consistent with the conditions the OCC has cited in prior letters dealing with partnership activities of national bank operating subsidiaries.

The Subsidiary will be adequately capitalized and, except in its capacity as paid investment adviser to the Fund, the Bank will be insulated from the partnerships. The partnership agreements will define and limit the activities of the partnerships to activities consistent with the powers of national banks and will recognize that the partnerships are subject to OCC regulation, supervision, and examination. The Subsidiary will have veto power over all of the Fund's activities. It has veto authority over all credit decisions and all investment decisions are made by a committee controlled by the Bank.

Finally, the Bank has agreed to comply with the previously set limitations on the operations of an operating subsidiary conducting certain activities by means of a partnership structure: (1) the Bank, the Subsidiary, and other Bank affiliates shall limit their total aggregate commitment to the limited partnerships, including contributions and extensions of credit (both direct and indirect) to five (5) percent of the Bank's primary capital. OCC Interpretive Letter No. 346, *reprinted in* [1985-1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,516 (July 31, 1985); and (2) the Bank's total aggregate contributions and extensions of credit to the Subsidiary may not exceed fifteen (15) percent of capital and surplus. *See* OCC Interpretive Letter No. 411, *supra*; OCC Interpretive Letter No. 423, *reprinted in* [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,647 (April 11, 1988).

In sum, given the purpose and characteristics of the partnerships and the Bank's and Subsidiary's level of participation, I find that the Bank is acting through its Subsidiary to develop and perform legally permissible banking activities by means of the two limited partnerships.

The proposed credit analysis and management activities of the Bank as investment adviser to the Fund are also permissible because they are incidental to a bank's power to make loans. Banks have traditionally performed their own credit evaluations and analyses, structured and negotiated loans, and monitored loan performance with respect to loan decisions made by the bank. Performing these services for the Fund for a fee pursuant to a formal investment adviser agreement, therefore, is likewise permissible.

As was the case with the suspended partnership approved by the 1988 letter, the Subsidiary's other general partner in the proposed limited partnerships is related to an investment bank. Consequently, the affiliation and employment interlocks issues under sections 20 and 32 of the Glass-Steagall Act, 12 U.S.C. 377 and 78, raised in the earlier approval are also at issue here. Although the limited partnerships are structured differently, with lower proportionate general partnership interests, the levels of participation of the general partners and the manner in which the partnerships' activities are conducted are substantially the same. The

analyses applied in the 1988 approval letter, therefore, apply here to reach the same conclusions.

Accordingly, the proposed limited partnerships would not cause the Bank to become affiliated with the Investment Bank and, thus, they are not prohibited by section 20 of the Glass-Steagall Act. Moreover, although the Bank by contractual agreement is the Fund's investment adviser, the limited partnerships and the Bank and the Investment Bank would be separate entities for purposes of section 32. Bank and Investment Bank personnel, therefore, would not be prohibited from employment by the limited partnerships.

Conclusion

For the reasons stated above, the OCC does not object to the proposal as described. This letter serves to notify the Bank, pursuant to 12 CFR 5.34(d)(1)(ii) and based on the representations made by the Bank to comply with the conditions set forth in the 1988 approval letter, that the Bank may establish an operating subsidiary to conduct the proposed activities. Please note that changes in the Subsidiary's proportionate interest in the limited partnerships, changes in the management and control provisions of the partnership agreements, and proposed changes in the identity of the other general partner will be considered new activities of the Subsidiary for purposes of the notification requirement of 12 CFR 5.34(d)(1).

Our position is based upon the representations made in your submissions to, and discussions with staff of, our office. Different facts or circumstances may lead to another conclusion. Our analysis also reflects current legal and prudent standards and may be subject to revision as future developments warrant. We reserve the right to modify the views expressed herein or to provide additional comments in the future.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

* * *

518 — April 6, 1990

This is in response to your letter dated January 5, 1990, to the Office of the Comptroller of the Curreny ("OCC"), in which you provided information and a legal opinion concerning the participation by * * * ("Bank") in two, related, debt/equity swap transactions involving the Bank's Brazilian and Costa Rican sovereign debt. The Bank considers the transactions to be authorized under its authority to acquire property in satisfaction of debts previously contracted ("DPC") and relies on earlier no-objection positions of the OCC staff addressing debt/equity swap transactions involving foreign public debt. I am providing this letter in order to clarify the scope of those earlier no-objection positions and to advise the Bank of the OCC's position regarding the transactions at issue.

The Transactions

As indicated in your correspondence, both transactions involve the Bank's accepting property from * * * ("Corporation"), a Colorado corporation engaged in oil and gas exploration and mining operations. The Corporation holds oil and gas leases on land in a number of states in the United States and a mining concession in Costa Rica. The Corporation is a reporting company with 4.5 million shares of common stock outstanding, and its stock is traded over the counter. Its closing price on January 3, 1990, was $6.00 per share, with high and low prices for the preceding 52 weeks at $6.25 and $3.75, respectively. As of September 30, 1990, the Corporation's net book value was $6 million. The Corporation reported a loss of $2.2 million for the nine months ending September 30, 1990.

Transaction I

As I understand the facts, in the first transaction ("Transaction I") the Bank exchanged Brazilian sovereign debt with a face value of $29,268,292.68 for 1,100,918 shares of the Corporation's Series A preferred stock, pursuant to a Stock Purchase Agreement with the Corporation dated as of December 22, 1989. Acting as agent for the Corporation's account, the Bank sold this Brazilian debt in the secondary market for net proceeds of $6 million. No foreign government was involved in Transaction I and it did not result in the extinguishment of any obligation of the government of Brazil or, through exchange, the debt of any other foreign government.

The preferred stock received has an aggregate liquidation preference of $6 million and is convertible into common stock at the option of the holder. Such conversion is mandatory if the market price of the common stock reaches $7.35 for 20 consecutive trading days. The Stock Purchase Agreement and a separate agreement with the Corporation's majority shareholder include various provisions intended to protect the Bank's interest in the event the preferred stock is converted into common. The investment representations given by the Bank in the Stock Purchase Agreement specifically allow for a disposition of the shares "as required by applicable law" which, according to your

[illegible] is intended to [illegible] the limited holding period applicable to DPC stock.

The sovereign debt exchanged by the Bank represents an obligation of a Brazilian company that is guaranteed by the Republic of Brazil and has been nonperforming since January 1987. Brazil's sovereign debt was rescheduled in 1988 but you indicate that Brazil has failed to perform under the rescheduled agreement. At the time of disposition, the secondary market value of the Brazilian debt exchanged was approximately 20.5 percent of the face amount, less applicable sales commissions. According to your letter, based on the Bank's evaluation of the value of the Corporation's existing domestic properties and of the likelihood that the Corporation will be granted certain Costa Rican oil concessions as described below, it is the Bank's business judgement that the securities received provide a reasonable opportunity for obtaining a significantly higher value than the continued holding of the debt or its sale in the secondary market. The Bank regards the liquidation preference of the preferred stock as adequate protection against the risk of loss. The Bank also considers the majority shareholder's stated intention of selling the Corporation within two to four years and recent inquiries including a firm acquisition offer for the company as indications that the Bank will be able to recover the value of its equity within the permissible holding period for stock acquired DPC.

Transaction II

You also indicate that the Bank and the Corporation have agreed to enter into the second transaction ("Transaction II") if and when the Costa Rican government grants the Corporation an oil concession on certain parcels in Costa Rica. Under the terms of a Debt Purchase Agreement to be executed at that time, the Bank will provide up to $3 million in face amount of Costa Rican sovereign debt in exchange for the right to receive royalty payments from oil produced on the concession parcels. The debt will be tendered to the Costa Rican government as consideration for the concessions granted and, accordingly, the face amount of the debt will be extinguished.

The Bank's internal evaluation of the Costa Rican debt to be exchanged reflects the view that Costa Rica demonstrates an inability to service external obligations, with poor prospects for restoration of debt service. The debt to be selected for exchange will likely have been nonperforming since November, 1986. You indicate that the Bank expects to receive the royalty payments in United States dollars, and that the Bank has evaluated the oil producing potential of the ex- [illegible] parcels. On this basis, the Bank has determined that ownership of the royalty right will place it in a superior position than if it continues to hold the debt or sells it in the secondary market.

Legal Analysis

As stated in your letter, the Bank considers both transactions to be authorized under its powers to acquire stock and other property DPC, and to be substantially similar to earlier proposals addressed in a series of OCC No-Objection Letters on debt/equity swaps. *See* OCC No-Objection Letter No. 89-1 (January 25, 1989), *reprinted in* Fed Banking L. Rep. (CCH) ¶ 83,009; OCC No-Objection Letter No. 88-7 (May 20, 1988), *reprinted in* Fed Banking L. Rep. (CCH) ¶ 84,047; OCC No-Objection Letter No. 87-10 (November 27, 1987), *reprinted in* Fed Banking L. Rep. (CCH) ¶ 84,039.

The statutory basis for a national bank to acquire property DPC is 12 U.S.C. 29 and 24 (Seventh). Section 29 of 12 U.S.C. provides that a national bank may "purchase, hold and convey real estate . . . such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings." Through analogy to 12 U.S.C. 29, the courts have interpreted the incidental powers of national banks granted in 12 U.S.C. 24 (Seventh) to authorize the acquisition and holding of personal property, such as stock, in satisfaction of debts previously contracted. *See First National Bank of Charlotte v. National Exchange Bank of Baltimore*, 92 U.S. 122, 127 (1875); *Atherton v. Anderson*, 86 F.2d 518, 525 (6th Cir. 1936), *rev'd on other grounds*, 302 U.S. 643 (1937). Real property acquired DPC is subject to the limitations contained in 12 U.S.C. 29 and 12 CFR 7.3025, and the OCC has applied similar limitations by analogy to stock and other property acquired DPC under a bank's incidental powers.

DPC authority is limited, as it is intended only to allow banks the possibility of recovering or reducing risk on loans that have significantly deteriorated or are in default. The OCC has recognized that foreign public sector debt may be eligible for DPC treatment when, in the opinion of bank management, the acquisition of property in satisfaction of the debt is necessary to prevent anticipated loss. In this context, the rescheduled or nonperforming condition of the sovereign debt is viewed as sufficient evidence of adverse change in the financial capacity of the borrower to permit a bank to exercise its DPC authority.

Property acquired DPC is generally subject to a five-year holding period under 12 U.S.C. 29 and applicable judicial and OCC precedent. Upon application to the OCC, the holding period may be extended on a yearly basis for up to an additional five years. However, a bank is obligated to dispose of DPC property prior to

the end of the holding period if it can recover the amount of the loan plus costs associated with preserving the asset.

A key element of DPC authority under 12 U.S.C. 29 is that the DPC transaction must involve some significant concession to the borrower, which can include the extinguishment of some or all of the debt owed, the substantial reduction of some of the interest owed, or some combination thereof, such that the bank's acquisition of the property operates as a total or partial "satisfaction" of the borrower's contractual obligation. This interpretation of the statute is consistent with the principle that DPC transactions are authorized only for the purpose of facilitating loan recovery. Loans are made by mutual agreement and, accordingly, the exercise of the power to acquire property in "satisfaction" of a troubled loan would require some benefit to the borrower's position under basic principles of contract law. In the foreign sovereign debt context, each of the transactions considered by the OCC in the above referenced No-Objection Letters involved the extinguishment of the face amount of the foreign sovereign debt tendered.

With respect to Transaction II, I agree that it is similar to the earlier transactions reviewed by this office and there is no objection to the Bank's participation in the Costa Rican debt/equity swap. Bank management has determined that rights to the royalty interest will be superior to the continued holding of the nonperforming and rescheduled Costa Rican debt. Whether the royalty interest to be assigned constitutes an interest in real property or in other property, it would be equally eligible for the Bank's acquisition under its DPC powers, as discussed above. The fact that the property to be received in satisfaction of the debt is not collateral for the loan or other property owned by the borrower does not affect the permissibility of the transaction under 12 U.S.C. 29 or 24 (Seventh). As in the earlier proposals, it is sufficient that the transaction results in the extinguishment of debt owed by the foreign government and is undertaken for the purpose of placing the Bank in a better position and not for speculative purposes. Finally, the Bank represents that its estimate of the value to be received incorporates the holding period limitations.

With respect to Transaction I, I do not agree with the Bank's evaluation that it conforms in all material respects to the transactions previously considered by this office. Certainly, the Bank has made the requisite showing of changed financial capacity on the part of the borrower, and Bank management has made the necessary business judgement that the acquisition of the preferred stock places it in a superior position to the continued holding of the debt. In addition, the Bank correctly notes that neither the type of property received nor the fact that the Brazilian debt was immediately sold in the secondary market should render the transaction ineligible under OCC precedent. However, unlike in Transaction II and the proposals addressed in the above referenced No-Objection Letters, in Transaction I the Bank dealt only with a third party. The transaction did not involve any benefit to the borrower whose debt was not reduced, extinguished or otherwise "satisfied." In effect, the Bank used the Brazilian debt as scrip for the purchase of the Corporation's preferred stock.

By contrast, the earlier foreign debt/equity swaps considered by this office involved either (1) the bank's tendering the debt directly to the original foreign sovereign borrower in return for local currency to be used in acquiring third party property through that country's debt/equity swap program, or (2) the bank's exchanging the original debt for another sovereign's debt and then tendering that debt to the second government in exchange for local currency to be used in that country's debt/equity swap program. In both types of transactions, the obligation of the foreign sovereign debtor corresponding to the face amount of the debt involved in the swap was extinguished. In addition, I note that in each case the swap resulted in the bank's ownership of property located in the foreign sovereign debtor's country and was accomplished under a debt conversion program offered by the sovereign debtor. Clearly, in the transactions previously considered by this office, the terms and conditions of the foreign debt/equity swaps were mutually acceptable to the debtor, the bank, and the owner of the property.

As discussed above, some concession to the borrower is integral to the exercise of a bank's DPC authority. The DPC authority is not intended to provide a general means whereby banks may use their troubled loans to purchase third party property in the open market in transactions wholly unrelated to the borrower. Accordingly, as it is my conclusion that the Bank's acquisition of the preferred stock in Transaction I was not authorized under its DPC powers, the Bank is advised to contact its supervisory office concerning the appropriate remedial measures to be taken. Any future debt/equity swap transactions entered into by the Bank must be structured so as to result in the substantial reduction or extinguishment of the debt owed.

The positions stated in this letter are based on your description of the transactions and the representations made in your letter dated January 5, 1990. Please be advised that the analysis provided herein is not intended as a departure from earlier discussions of DPC authority in the debt/equity swap context, nor does it modify the conditions under which national banks hav

[illegible] DPC property, when the borrower is not a [illegible]

Peter Liebesman
Assistant Director
Legal Advisory Services Division

* * *

Investment Securities Letters

42 — October 16, 1989

This will confirm your October 3, 1989, telephone conversation with Robyn Becker Ide of the Office of the Comptroller of the Currency ("OCC") concerning the Notice of Nonpublic Offering ("Notice") filed pursuant to 12 CFR 16.3(a) and 16.5, on behalf of A, a wholly owned subsidiary of B.

As we understand the facts, A acquired 172,500 shares of the bank's common stock (100 percent of the issued and outstanding securities) on April 20, 1989, by foreclosure in partial satisfaction of debt previously contracted in good faith ("DPC Stock"). A is complying with the provisions of 12 CFR 16.5 for the sale of the DPC Stock consistent with the OCC's interpretation of 12 CFR 16.3(a). *See* OCC's Interpretive Letter No. 481, *reprinted in* [Current] *Fed. Banking L. Rep.* (CCH) ¶ 83,031. Section 16.3(a) states that

> No bank shall, directly or indirectly, offer, offer to sell, offer for sale or sell any security of which it is the issuer unless the offer, offer to sell, offer for sale or sale is made through the use of an offering circular which has been filed with, and declared effective by the Comptroller of the Currency.

The OCC has intepreted the language "or indirectly" in section 16.3(a) to include any offers for sale of bank securities in a public or private offering by a corporation, person, affiliate, or bank holding company, etc., that owns 100 percent of a bank's issued and outstanding securities. The OCC believes that the bank would be indirectly involved in the offering of its securities, thereby subjecting the holders of the securities to compliance with the provisions of 12 CFR 16.

The Notice states that A is proposing to offer and sell the DPC Stock to an individual at an offering price of $2.90 per share for an aggregate offering price of [illegible]. You stated to Mrs. Ide that the securities have been offered to * * *, Chairman of the Board of the subject bank. You confirmed to Mrs. Ide that A has reasonable grounds to believe that Mr. * * * as Chairman of the Bank's Board of Directors, has sufficient knowledge and experience in business and financial matters affecting the bank to be capable of understanding the risks of his prospective investment. *See* 12 CFR 16.5(a). The offer to purchase the DPC Stock was made through a privately negotiated transaction between Mr. * * * and B, the parent of A. You confirmed that Mr. * * * has had access to, at least, the financial data concerning the bank as required by 12 CFR 16.5(c), prior to the acceptance of the offer.

Mrs. Ide communicated to you that, based on the facts set forth above, the OCC would not object to A's reliance on the exemption provided in 12 CFR 16.5 for the offer and sale of the DPC Stock to Mr. * * *. You were advised, however, that the actual sale of the DPC Stock was subject to Mr. * * *'s prior compliance with the Change in Bank Control Act of 1978. *See* 12 U.S.C. 1817(j) and 12 CFR 5.50. Further, Mrs. Ide advised you that the OCC would waive the requirements in 12 CFR 16.5(e) regarding the limitations on the disposition of the DPC Stock on the condition that you would inform Mr. * * * that any future disposition of the securities would be subject to compliance with the provisions of 12 CFR 16.

William Dehnke
Acting Assistant Director
Securities & Corporate
Practices Division

* * *

43 — January 10, 1990

This is in response to your letter of November 8, 1989, requesting clarification of this office's position on indemnification by national banks of legal expenses incurred by directors, officers, or employees in defending actions brought under 12 U.S.C. 93(a) or 1818. Recognizing that such actions may be conducted over a prolonged period of time, you ask whether payment by the bank of attorneys' fees and other expenses under an indemnification agreement would be permissible, subject to reimbursement to the bank in the event penalties were ultimately imposed. You state that in Investment Securities Letter No. 42 (which has been redesignated as Interpretive Letter No. 483) there is no express indication that indemnification would be afforded an accused to meet mounting legal fees and costs until a final order is entered in an action declining to assess civil money penalties. You believe such a case might not be defended, due to potential impoverishment of the accused, if advancement of expenses is not permitted.

As you know, under 12 CFR 7.5217, a director, officer or employee may not be indemnified against expenses incurred in an action instituted by the Comptroller which results in a final order assessing civil money penalties or requiring payments to the bank. Further, any articles providing for payment of insurance premiums by the bank shall explicitly exclude coverage of liability for a formal order assessing civil money penalties against a director or employee.

The arrangement you have proposed could potentially conflict with 12 C.F.R. 7.5217. If the individual is unable to reimburse the bank at the time the penalty is ultimately imposed, the bank may have effectively indemnified the individual for such expenses, contrary to 12 CFR 7.5217. Depending on the level of expenses and condition of the bank, such payments also could impact bank safety and soundness.

To ensure that advances by a bank for such expenses do not result in violations of section 7.5217, a bank should take the following precautions. All advances must be subject to reimbursement if a final order is entered in the action assessing civil money penalties or requiring payments to the bank. Moreover, before any advances are made, the board, in good faith, must determine, in writing, that all the following conditions are met:

(1) the officer, director, or employee has a substantial likelihood of prevailing on the merits;

(2) in the event the officer, director, or employee does not prevail, he or she will have the financial capability to reimburse the bank; and

(3) payment of expenses by the bank will not adversely affect bank safety and soundness.

If at any time the board believes, or should reasonably believe, that either conditions (1), (2), or (3) are no longer met, the bank must cease paying such expenses or premiums. Further, the board should enter into a written agreement with the director, officers, or employee specifying the conditions under which he or she will be required to reimburse the bank. At a minimum, the agreement shall require reimbursement for expenses already paid, if and to the extent the board finds that the director, officer, or employee willfully misrepresented factors relevant to the board's determination of conditions (1) or (2), or if a final decision assessing penalties or requiring payments is returned. The bank should ensure that it complies with all applicable laws and regulations affecting loans to directors, officers, and employees, including but not limited to 12 U.S.C. 84, 375a and 375b, and 12 CFR 215, in the event reimbursement is required.

Banks that wish to make advances in accordance with the procedures described above must amend their articles of association to authorize such indemnification and to incorporate the above restrictions on advances prior to the entry of a final decision. Before shareholders vote on such amendments to the articles of association, they must be provided with the following disclosures:

(1) Interpretive Ruling 7.5217

(a) prohibits a bank from indemnifying a director, officer, or employee against expenses incurred in an action instituted by the OCC which results in a final order assessing civil money penalties or requiring payments to the bank; and

(b) requires that any articles providing for payment of insurance premiums by the bank shall explicitly exclude coverage of liability for a formal order assessing civil money penalties against a director or employee;

(2) Advancement of expenses will be allowed if the bank follows the above outlined procedures to prevent such payments from conflicting with 12 CFR 7.5217; and

(3) An explanation of the reasons for the bank's adoption of the procedures.

Ellen Broadman
Director
Securities and Corporate
Practices Division

* * *

Trust Interpretations

250 — July 3, 1990

This is in reply to your letter dated March 5, 1990, pertaining to the regulatory accounting principles for collective investment funds established under 12 CFR 9.18(a)(2). Specifically, the bank requests an opinion from the OCC that trade date plus one accounting can be used to determine the unit values of pooled or group investment funds.

Subject to the conditions stated below, the OCC does not object to the use of trade date plus one accounting for the bank's pooled or group funds which are valued daily.

The bank intends to begin valuing assets of some of its 12 CFR 9.18(a)(2) funds on a daily basis. Daily valuation is sought by the bank to better accommodate its customers' needs by managing trust assets more timely and effectively. Participants in employee benefit plans will be able to ascertain the value of their assets daily, and to transfer those assets among several collective investment funds representing different investment strategies.

The use of trade date plus one accounting will make daily valuation of assets operationally feasible. The trade date plus one accounting method reflects changes in securities positions in daily net asset value computations as of the business day following the trade date. When valuing assets for any business day, it excludes the trade executed on that day. If a security is purchased, it reflects the cash used to buy the security on the trade date, and it reflects the actual value of the security acquired beginning on the following business day. If a security is sold, it uses the end-of-day value of the security on the trade date and reflects the cash to be received from the sale beginning on the following business day.

The trade date plus one accounting method is currently used in determining the current net asset value of mutual funds. It is permitted by 17 CFR 270.2a-4(a)(2).

As explained above, the OCC will not object to the use of trade date plus one accounting for pooled or group funds using daily valuation. However, the board of directors of the bank is responsible for the fair and accurate valuation of fund assets. (See 12 CFR 9.7 and 18.) In order to use the accounting method for determining the current asset value of an investment trust, the board must assure itself that policies and procedures are in place to value fund assets at market value or a fair value as determined in good faith as of the trade date. A comparison of net asset values should be made between valuations using trade date and trade date plus one. If the net asset value of a fund unit using trade date plus one accounting differs from that derived under trade date accounting by more than one-half of 1 percent of the net asset unit value derived under the trade date accounting, then the value derived under trade date accounting must be used. Should inaccurate unit values be used, the bank as trustee (or in some circumstances, the board of directors) will be responsible for making the fund/participants whole. This would be consistent with the standards for the valuation of assets of a registered investment company.

Before the bank implements the proposal it should obtain the reasoned opinion of counsel as to whether any dilution of a trust beneficiary's interest even within the parameters established above is permitted under the governing law of trusts. Should the bank use trade date plus one valuation, the valuation sections of the plans of operation should be amended to reflect its use and the fact that any resultant deviation in unit values will be less than .005. Fund participants should be informed in writing and given an opportunity to withdraw from the fund before the amendment becomes effective. Additionally, financial statements of the fund must continue to be presented on a trade date basis.

This opinion only addresses the question of trade date plus one valuation as it pertains to 12 CFR 9.18(a)(2) funds for employee benefit accounts. We express no opinion as to the proposal's compliance with any other law or its impact on collective investment fund administration generally. Additionally, this review is based upon current regulation and may be subject to revision as circumstances warrant. This office further reserves the right to modify the position taken herein or to provide additional guidance in the future.

Dean E. Miller
Senior Advisor
for Fiduciary Responsibilities

* * *

251 — July 31, 1990

We received your letter dated May 31, 1990, pertaining to the * * * (the "Fund") for the investment of personal trust assets.

As discussed below, the OCC does not object to the application of the doctrine of consent being limited to an income beneficiary when only that beneficiary's interests are being affected.

The bank charges its usual trustee's fees to the individual participating trusts. These fees are separately charged to the principal and the income of the participating trust. To the extent that foreign ordinary shares are held, the bank proposes to charge additional fees. The additional fees are charged against the income earned by the Fund. These fees will increase the compensation of the trustee and pay the expenses of the Fund's global custodian. The additional fees at the Fund level are an amount equal to an annual rate of .3 percent of the average daily net value of units held in the Fund. The bank discloses the management fee to all participating accounts and to other accounts before their participation in the Fund.

The bank requests approval to admit participating accounts to the Fund and to pay additional fees and expenses in the following manner:

> Each participating account would authorize in its governing instrument or through the use of an authorization agreement (1) the investment in the Fund and (2) the payment of additional fees from the Fund. The bank would obtain consent from the donors of revocable trusts. For irrevocable simple trusts, the bank proposes to obtain consent only from the income beneficiary. In the case of a complex trust in which some income may be allocated to principal and the consent of all remaindermen cannot be obtained, the bank would rebate its proportionate share of its .3 percent fee to the participating trust.

The OCC does not object to the application of the doctrine of consent being limited to income beneficiaries, when their rights and their rights only are being impacted. In the context presented, the beneficiary is consenting to the trustee receiving an additional fee as well as the expense allocation between principal and income. (See 12 CFR 9.18(b)(12) and 13 ORCA 1340.12.) For the doctrine of consent to be effective, the beneficiary must be of full age and sound mind, acting with full knowledge of the facts and of his legal rights, and not under the influence of misrepresentation, concealment, or other wrongful conduct on the part of the trustee. Since the trustee is personally benefiting by the increase in fees, the trustee has the responsibility, the burden of proof, that the consent was obtained with utmost fairness and full disclosure.

The limited consent of the income beneficiary is valid only as it pertains to the receipt of the additional fees charged to income. This limited consent would not be adequate in those situations in which authorization is necessary to invest in foreign securities. The law of trusts would require that the rights of those having even a contingent principal interest be fully represented in a principal transaction.

The above analysis of the limited consent issue is based on the facts as reflected in your letter; if circumstances change or differ from those presented, a different analysis may result. Furthermore, our view is based upon our understanding of the general law of trusts, and the assumption that the law of the situs does not vary from this general law.

Dean E. Miller
Senior Advisor for
Fiduciary Responsibilities

* * *

252 — July 13, 1990

This responds to the request for legal review of the issues raised in * * * (Bank's) letter dated February 14, 1990, to the Office of the Comptroller of the Currency (OCC's) District Counsel Patrick Parise. The questions addressed in your letter centered around the application of seven consumer laws and regulations to the trust departments of national banks.

Discussions were held with the Legal Advisory Services Division and Compliance Management-Policy staff in Washington, D.C. Set forth below are our conclusions concerning the issues discussed in your letter.

Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA), 15 U.S.C. 1691, is intended to prevent creditors from discriminating against applicants for credit (1) on the basis of race, color, religion, national origin, sex, marital status, or age; (2) because the applicant receives income from public assistance programs; or (3) because of the applicant's good faith exercise of any right under the Consumer Credit Protection Act. The ECOA is implemented by the Federal Reserve Board's (FRB) Regulation B and applies to any "creditor," which is defined to include "a person who, in the ordinary course of business, regularly participates in the decision of whether or not to extend credit." 12 CFR 202.2(1). The Bank inquires whether the "person" referenced would be the bank acting as trustee or the individual trust in a transaction involving a decision whether or not to extend credit from the trust.

You letter indicates that FRB staff has informally advised the Bank that the "person" in such transactions would be the individual trust and not a bank as trustee. Even though a bank as trustee literally "participates in the decision whether or not to extend credit," the staff position is that the trustee acts as an agent or employee of the trust and that the trustee is therefore identified with the trust for purposes of Regulation B. Accordingly, under this interpretation which we have informally confirmed with the FRB staff, the business of the trust itself rather than the collective business of the bank trustee should be evaluated to determine whether Regulation B applies.

The Bank also seeks guidance on which agency should be disclosed to applicants as having authority to administer compliance with the ECOA, when an individual trust is a "creditor" under the act. The ECOA provides that the OCC has enforcement authority in the case of national banks and that the Federal Trade Commission (FTC) has enforcement authority in any case for which another governmental agency is not

[illegible] enforcement authority. *See* ECOA, section 704(a) and (c). Thus, the issue is whether the OCC or the FTC has enforcement authority when the creditor is an individual trust which has a national bank as trustee.

Because the trustee is the entity with discretion to make credit decisions on behalf of an individual trust, the trustee will be responsible for the trust's compliance with the ECOA. As trustee, the national bank would also be required to defend the trust in the event of an enforcement action brought under the ECOA. Given that the trustee has these substantive functions with respect to the ECOA, it is logical that the OCC, the agency charged with enforcing the ECOA in the case of national banks, should have jurisdiction over national banks acting as trustee for trusts that are subject to the ECOA. Therefore, the OCC would expect to be named as the agency with enforcement authority for cases involving national bank trustees. As this question has not been decided by any court, you may also wish to consult with the FTC.

Fair Housing Act

The Fair Housing Act (FHA), 42 U.S.C. 3601, prohibits discrimination in all aspects of the sale, financing, or rental of housing on the basis of race, color, religion, sex, handicap, familial status, or national origin. The FHA is a broad, remedial statute intended to implement "the policy of the United States to provide, within constitutional limitations, for fair housing throughout the United States." FHA, section 801.

The Bank questions the extent to which the FHA applies to trust department activities that involve (1) the sale or rental of trust assets consisting of residential property, and (2) extensions of credit from trust funds for purposes of financing residential housing. The bank also inquires whether the fair housing poster required to be displayed under the Department of Housing and Urban Development's (HUD) implementing regulations must be posted in the trust department. As discussed below, it is our conclusion that the prohibitions contained in the FHA apply to a bank acting as trustee regardless of whether the individual trust involved would be subject to the act. Also depending on its activities we conclude that an individual trust might also be subject to the act.

Discrimination in sale or rental. Section 804 of the FHA broadly states that "it shall be unlawful" to discriminate in the sale or rental of housing or to engage in other specified discriminatory housing practices. The exception that could apply to the Bank's inquiry is contained in section 803(b). This section provides an exception from section 804 for any single family house sold or rented by a private individual owner who does not own or have any interest in more than three such houses at one time, provided that (1) the exception applies only once within any two-year period if the owner did not reside in the house or was not its most recent occupant at the time of disposition, and (2) the house may not be sold or rented using the services of any real estate broker, agent, salesman, or the facilities of any person in the business of selling or renting dwellings.

The Bank questions whether section 804 applies to the bank itself, acting as trustee, or whether each trust must be considered separately under this section. The OCC has historically interpreted section 804 as applying to national banks acting as trustees. Assuming that section 804 applies to the bank as trustee, it also seems clear that the exception provided in section 803 would not be available. A national bank trustee would not be a "private individual owner" capable of residing in the dwelling, and the bank as trustee would be likely to own (have legal title to) more than three single-family houses.

Because section 804 is so broadly worded, we conclude that its prohibitions would also apply separately to each individual trust. While the statute is not explicit, the use of the words "private individual owner" and the references to the owner's "residence" indicate that the exception is intended for natural persons. Also, any sale or rental of trust property would necessarily involve using the services of the trustee. As noted above, section 803 exempts only transactions that are effected without the use of a "real estate broker or agent . . . ." The terms "broker" and "agent" are broadly defined in HUD's regulation to include any person "authorized to perform an action on behalf of another person regarding any matter related to the sale or rental of dwellings . . . including offers, solicitations or contracts and the administration [thereof] . . . ." 24 CFR 100.20. In view of the expansiveness of this definition, it appears that the use of the trustee's services in selling or renting the trust property would constitute the use of a real estate "broker" or "agent" and would therefore render the exemption unavailable for the trust.

Discrimination in financing. Section 805 of the FHA provides that "it shall be unlawful for any person or other entity whose business includes engaging in residential real estate related transactions to discriminate . . . in making available such a transaction, or in the terms or conditions of such a transaction . . . ." The term "residential real estate-related transaction" is broadly defined to include extensions of credit secured by residential real estate or for the purpose of acquiring or maintaining a dwelling, as well as the selling, brokering, or appraising of residential property. The Bank inquires whether the collective activities of the national

bank as trustee or the separate activities of each individual trust should be evaluated in determining the application of this section.

As with section 804, section 805 establishes a broad prohibition against discrimination. The section applies to any "person" whose "business includes" the described activities. The FHA defines "person" to include "trusts," "trustees," and "fiduciaries." *See* FHA, section 802(d). A national bank as trustee, which would ordinarily have discretion to make lending decisions on behalf of numerous trusts, would be a "person" that could be engaged in a business that "includes" residential real estate related transactions. Additionally, because the FHA definition of a "person" also includes a "trust," it is also possible that section 805 will apply to an individual trust, based upon the extent of an individual trust's residential real estate activities.

Fair housing poster. The Bank also inquires whether the fair housing poster required under HUD's regulation, 24 CFR 110, must be posted in the trust department. This regulation applies to all persons subject to sections 804 through 806 of the FHA. *See* 24 CFR 110.1. Depending upon where the Bank's trust department is located relative to the main lobby (assuming the poster is already posted there), the Bank should determine if additional posters are required. For example, if persons entering the trust department to engage in transactions covered by the FHA would not be aware of existing posters, the simple and prudent course would be for the Bank to post an additional poster in the trust department. The Bank should be aware that in the event of a lawsuit, failure to comply with this regulation will be deemed *prima facie* evidence of a discriminatory housing practice. *See* 24 CFR 110.30.

Fair Credit Reporting Act

The Bank questions whether the Fair Credit Reporting Act (FCRA) applies if a national bank acting as trustee uses information contained in a consumer report as part of its determination whether to lease trust-owned property to a consumer. The question presented is whether the denial of a lease would constitute the denial of "credit" for purposes of the FCRA.

The only court to have addressed this matter, to our knowledge, has concluded that the FCRA's adverse notification requirements can apply to leasing transactions. *See Ferguson v. Park City Mobile Homes*, No. 89-C-1909 (N.D. Ill. Sept. 15, 1989). In this case the court first concluded that the ECOA can apply to a lease transaction, based on the broad definition of "credit transaction" contained in the act. *See also Brothers v. First Leasing*, 724 F. 2d 789 (9th Cir.), *cert. denied*, 489 U.S. 832 (1984). Regarding the FCRA issue, the court stated "[a]s an economic matter, any lease to be paid in installments is a credit transaction since the willingness of the lessor to defer payments over the life of the lease depends upon the perceived creditworthiness of the lessee." *Ferguson* at 5.

Electronic Fund Transfer Act

The Electronic Fund Transfer Act (EFTA), 15 U.S.C. 1693, applies to electronic fund transfers to or from consumer "accounts." The Bank inquires whether the EFTA applies to electronic fund transfers involving trust accounts. We agree with the Bank's conclusion that transactions involving trust accounts are not subject to the EFTA. The definition of "account" contained in Regulation E, the FRB's regulation implementing the EFTA, specifically excludes "an account held by a financial institution pursuant to a bona fide trust agreement." *See* 12 CFR 205.3(f). *See also* 12 CFR Part 205, Supp. II Question 3-20 (discussing custodial agreements).

12 CFR Part 590

Under the Office of Thrift Supervision's regulation at 12 CFR 590, state usury laws are preempted and made inapplicable to "federally related loans" secured by residential property. The Bank inquires whether the lending activities of the trust department as a whole should be evaluated or whether the lending activities of each individual trust should be considered separately for purposes of determining this regulation's application. Based upon our reading of the regulation, each trust's loans must be considered separately to determine whether they are subject to 12 CFR 590.

Real Estate Settlement Procedures Act

The Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. 2601, requires certain disclosures to borrowers and provides protection against certain abusive practices in connection with the real estate settlement process. The act applies to "federally related mortgage loans" made by "lenders," as defined in HUD's implementing regulation under RESPA, Regulation X. *See* 24 CFR 3500. For purposes of determining whether this act applies to loans made through its trust department, the Bank inquires whether the definition of "lender" should be applied to the trust department as a whole or to the individual trusts. Based upon our review of the act and Regulation X, we conclude that each trust's activities must be considered separately to determine whether RESPA applies to loans funded with trust assets. See *Comptroller's Handbook for Consumer Examinations*, Appendix — section 503.209.2.

Under the Flood Disaster Protection Act (FDPA), 42 U.S.C. 4002, federal financial institution regulators are directed to issue regulations prohibiting institutions under their jurisdictions from extending credit secured by improved real property in certain areas unless the property has flood hazard insurance. The OCC's implementing regulation under the FDPA is 12 CFR 22. The Bank inquires whether loans funded with trust assets and made through a national bank's trust department are subject to the FDPA.

As your letter points out, the OCC's regulations apply to "certain loans secured by improved real estate made by banks . . ." (emphasis added). The term "bank" is defined to mean a national banking association, with no reference to the bank as trustee. Based on this plain language reading of the regulation, and in view of the congressional concern expressed over the extent to which the assets of federally regulated or insured financial institutions consist of loans made in flood hazard areas, we agree that this regulation does not reach loans funded from individual trusts. *See* 42 U.S.C. 4002(a)(4) – Congressional Finding. However, in order for the Bank to comply with its fiduciary obligations as trustee, it may still be necessary for the Bank to require flood insurance coverage for property that secures loans extended from individual trusts.

John H. McDowell
Acting Director
Compliance Management Programs

* * *

253 — June 4, 1990

This is in reply to your letter of May 24, 1990, in which you request our opinion relating to the administration of the common trust funds operated by your bank.

You indicate that your institution is a small state-chartered trust company, which operates five common trust funds. Because all accounts participating in these funds are trust accounts, you have chosen to operate these funds pursuant to 12 CFR 9.18(a)(1). You state that you commingle all types of trust accounts in these funds, including pension, profit sharing, revocable trusts and IRA's.

The State Banking Commissioner and the examiners from the Federal Reserve have indicated that there is a potential disqualification of the tax exempt status of the participating pension, profit sharing, and IRA accounts because of their commingling with other trust accounts in the funds operated by your trust company, citing section 584 of the Internal Revenue Code. You have requested the OCC's position on this issue.

Assuming we understand the nature of your question, I can only state that we do not share the conclusion of the State Banking Commissioner and the Federal Reserve examiners. We know of no reason in this fact situation that the tax exempt status of the employee benefit trusts, including the IRA's, would be jeopardized.

Dean E. Miller
Senior Advisor for Fiduciary Responsibilities

* * *

254 — June 5, 1990

This is in reply to your letter of May 22, 1990, in which you request an interpretation of section 9.18(b)(4) of Regulation 9, as it would apply to a collective investment by your bank in a fund managed by a bank affiliated with your bank.

Specifically, you inquire whether the requirements of this section relating to admissions to collective investment funds are met if, prior to each valuation date, there is submitted a list of names (which I presume to mean, account names), showing the amount of funds available for each individual (which I presume to mean, account) to purchase units in a collective investment fund, to a designated committee for approval. You inquire whether, upon receipt of that approval, the list should be made a part of the fiduciary records of your bank, or the records of the affiliate bank which is managing the fund.

It is our opinion that the foregoing procedure would satisfactorily comply with the requirements of the regulation if the list were made a part of the records of both banks.

Dean E. Miller
Senior Advisor for
Fiduciary Responsibilities

* * *

255 — June 21, 1990

This is in reply to your letter of June 7, 1990, in which you inquire whether Keogh plans which satisfy the requirements of SEC Rule 180 may be collectively

invested in funds qualifying under section 9 18(a)(2) of the regulations of this office.

As Rule 180 is promulgated by the Securities and Exchange Commission, this office has no authority to interpret its provisions. As you know, this rule establishes the standards by which the Commission staff determine whether the collective investment fund exemptions from the securities laws are available. I suggest that you contact that agency for such advice. I would only add that the regulations of this office do not preclude such investments in a collective investment fund.

Dean E. Miller
Senior Advisor for
Fiduciary Responsibilities

* * *

256 — July 9, 1990

This is in reply to your letter for an opinion regarding a proposal by the bank to market interests in a limited partnership to the bank's trust department customers. The facts of the proposal, as represented by you and * * *, Esq., of your firm, in letters and telephone conversations with the staff of the Securities and Corporate Practices Division, are recited below. You have asked for an opinion regarding whether the bank's activity would constitute the collective investment of trust funds governed by 12 CFR 9.18. The bank's proposal involves other federal banking and securities law issues, which are also discussed below. In response to your original request, the bank's activity under the proposal outlined below does not appear to constitute the collective investment of trust funds under 12 CFR 9.18. In addition, if the limited partnership interests are sold in a private placement to no more than 100 investors, the bank's proposal would not appear to violate federal banking or securities laws.

Facts

The bank would like to make available for investment to its trust and custodial accounts interests in a new limited partnership in which * * * will be the general partner and investment manager. * * * has traditionally functioned as a general partner and investment manager for various limited partnerships organized under the laws of the state of Colorado for the purpose of purchasing, selling, investing, and trading in securities and the rights and options to purchase and or sell securities which are traded on national security exchanges. The assets of the new limited partnership will be commingled with those of other similar limited partnerships in * * *, a limited partnership organized under the laws of Colorado in which * * * Inc., a Colorado corporation, is general partner. The bank has entered into an agreement whereby it will be the exclusive marketing representative in South Dakota and Minnesota, except for a limited number of exceptions for * * *. The bank proposes to market interests in the new limited partnership managed by * * * to its trust and custodial accounts.

Three agreements will govern the bank's proposal. First, the bank has entered into a marketing agreement with * * * and * * *, who has been engaged in soliciting accounts for * * * in Minnesota and South Dakota. Pursuant to the marketing agreement, the bank will be the exclusive marketing representative for * * * in Minnesota and South Dakota. The marketing agreement will be for a term of one year and will be automatically renewed for additional one year periods unless the bank fails to place and maintain at least $2,000,000 within the first 12 months, in which case * * * may terminate the agreement upon 90 days' notice given within 6 months of the end of the 12 days' notice given with 6 months of the end of the 36th month of the agreement if the Bank fails to place and maintain at least $5,000,000. Thereafter, the agreement will be automatically renewed from year to year, except that * * * may terminate the agreement if the bank has not sold and maintained at least $2,000,000 additional placements during the preceding fiscal year. The Bank will receive no fees for its marketing effort other than its traditional trustee and custodian fees and transaction charges it receives from the trust and custodial accounts.

The second agreement is a profit sharing agreement which will be entered into between each limited partner and * * *. Pursuant to this agreement, * * * will receive no fees if the value of the limited partnership fund does not increase by at least 15 percent during the calendar year. Its fee rises to 100 percent of the increase between 15 and 18.75 percent, and 20 percent of any fund increases over 18.75 percent. According to the marketing agreement and the letter, the fee is reduced for accounts which exceed $2,000,000 as of January 1 of any year; however, this is not mentioneo in the profit sharing agreement.

The third agreement is the limited partnership agreement which will be between * * *, as general partner, and the bank's participating trust and custodial accounts, as limited partners. This agreement governs all aspects of the business of the partnership, except the fees, which are governed by the profit sharing agreement described above. Examples of the matters included in the limited partnership agreement include

how earnings or losses will be allocated to the limited partners, how limited partners may withdraw funds and how limited partners may terminate their accounts

The bank intends to offer interests in the limited partnership as an investment alternative to its trust and custodial accounts over which it has no investment discretion. The investment will only be made at the written direction of the holders of the custodial accounts, the grantors of grantor trusts, and the investment advisors or committees of employee benefit plans. The bank will never own an interest in the limited partnership for its own account, and will not loan money to the trust accounts for the purpose of purchasing partnership interests. Additionally, the bank will generally promote the limited partnership by direct contact with current and prospective trust department customers that have the resources and investor sophistication to purchase * * * units.

Discussion

The bank's activity under the proposal would not constitute the collective investment of trust funds under 12 CFR 9.18. The limited partnership interests are merely alternative investments that will be made available to certain trust department customers. The Bank will not commingle trust assets.[1]

The proposal does, however, raise a number of additional issues which the bank should resolve before undertaking the sale of partnership interests. First, the bank should satisfy itself that these interests are exempt from registration under the federal securities laws. According to Mr. * * *, * * * will not register the limited partnership under the Securities Act of 1933, 15 U.S.C. 77a (Securities Act), and will not register the limited partnership under the Investment Company Act of 1940, 15 U.S.C. 80a (Investment Company Act). Instead, * * * will rely on the nonpublic offering exemption from the Securities Act, which is found at 15 U.S.C. 77d(2). Similarly, * * * will rely on the small company exemption from the Investment Company Act, found at 15 U.S.C. 80a-3(c)(1). The OCC can offer no opinion on the availability of these exemptions, and recommends that the bank receive an opinion of counsel confirming the exempt status of the partnership and its interests under the Securities Act and Investment Company Act. Further, since both of the exemptions require the bank to conduct a private placement of securities, the bank should take care to conduct its private placement within the constraints of the Securities Act and Investment Company Act.

Another issue raised by the proposal is whether the bank's activity would constitute underwriting or dealing in securities which would be prohibited under the Glass-Steagall Act. Even assuming that the limited partnership interests are Glass-Steagall Act securities, the bank's activity would not violate Glass-Steagall if the sales are conducted in a private placement. A private placement of securities would not involve a "public offering" of securities, which is required for there to be an impermissible "underwriting" or "dealing" under Glass-Steagall.

Under section 16 of the Glass-Steagall Act, "[t]he business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock." 12 U.S.C. 24 (Seventh). The statute's plain language therefore states that banks may sell securities as agent to their customers, or for their customers, but they may not engage in "underwriting." The term "underwriting" is not defined in the Glass-Steagall Act, but has usually been interpreted to require a public distribution of securities as compared to a private placement of securities. *See Securities Industry Association v. Board of Governors of the Federal Reserve System, et al. Bankers Trust Company*, 807 F.2d 1052, 1063-1066 (D.C. Cir. 1986) *cert. denied* 483 U.S. 1005 (1987); Interpretive Letter No. 329 (March 4, 1985), *reprinted in* [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,499. *See also* Interpretive Letter No. 496 (December 18, 1989), *reprinted in* [1989-90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,087 (discussing sale of limited partnership interests where operating subsidiary acts as general partner for a financial products limited partnership).

After reviewing the bank's proposal, the proposed activity does not appear to be a public offering of securities. First, the bank will sell the limited partnership interests only to institutional investors and other high net worth clients of its trust department. Second, the bank will not be marketing the interests through general advertisements and solicitations to the public, but rather through privately negotiated transactions. Third, the sales will be conducted in a manner that will satisfy the nonpublic offering exemption from the Securities Act. It is reasonable to conclude, therefore, that the proposed sales will not involve a public offering. Without a public offering, there is no "underwriting" as

[1] Although 12 CFR 9 does not contain a definition of the term "collective investment fund," it is clear from the plain language of 12 CFR 9.18(a) that the bank's proposal does not constitute an attempt by a national bank as a fiduciary to invest funds in a common trust fund that it maintains exclusively for the investment or reinvestment of funds which it holds in its capacity as trustee.

that term is understood in Glass-Steagall analysis. To the contrary, it appears that the bank's activity will be limited to selling securities as agent for its customers, well within the permissive language of 12 U.S.C. 24 (Seventh).

Another issue is whether the bank's activities under its proposal conflict with its existing fiduciary duties to its customers. The bank is required under the marketing agreement to place and maintain certain amounts of limited partnership interests, or it will lose its exclusive right to market the interests. The bank does not receive a commission for selling the interests. It will receive only traditional trustee and custodial fees under existing arrangements for the services it currently provides. Its only interest in selling the interests, therefore, is to maintain its exclusive right to sell the interests as a marketing tool for signing up new trust department customers. If the bank loses its marketing rights, it loses a marketing tool for its trust department. It thus has an interest in selling limited partnership interests rather than being neutral on trust investments. Because the bank plans to make partnership interests available only to nondiscretionary accounts that will be directed only by persons deemed sophisticated for the purposes of the federal securities laws, this potential conflict of interest would not arise. As long as the bank's interest in maintaining the marketing arrangement is fully disclosed to potential investors, as would be required under the federal securities laws, there is no impermissible conflict of interest that would prevent the bank from observing its fiduciary duties to its trust customers.

Conclusion

The bank's activity under the proposal does not involve the collective investment of trust funds regulated under 12 CFR 9.18. Further, the OCC recommends that the bank receive an opinion of counsel confirming the exempt status of the limited partnership and its interests under the Securities Act and Investment Company Act. Please also be advised that it is entirely the bank's obligation to insure that, through its participation in this proposal, it does not violate or assist in the violation of any federal banking or securities laws. Finally, the bank should fully disclose its marketing relationship with * * * to all offerees, including the minimum amounts of partnership interests it must sell in order to maintain its exclusive marketing rights.

Dean E. Miller
Senior Advisor for
Fiduciary Responsibilities

* * *

Mergers — July 1 to September 30, 1990

Mergers consummated involving two or more operating banks.

Mergers consummated involving national banks and savings and loan associations.

A number of transactions in this section do not have an accompanying decision. In those cases, the OCC reviewed the competitive effects of the proposals by using its standard procedures for determining whether the transaction has minimal or no adverse competitive effects. The OCC found the proposals satisfied its criteria for transactions that clearly had no or minimal adverse competitive effects.

SECURITY PACIFIC NATIONAL BANK,
Los Angeles, California, and La Jolla Bank & Trust Company, La Jolla, California

Names of institutions and type of transaction	*Total assets*
Security Pacific National Bank, Los Angeles, California (2491), with	$51,261,000,000
and La Jolla Bank & Trust Company, La Jolla, California, with	544,000,000
merged August 23, 1990, under charter and title of the former. The merged bank at date of merger had	54,858,000,000

* * *

THE BANK OF CHERRY CREEK, NATIONAL ASSOCIATION,
Denver, Colorado, and Cherry Creek National Bank, Denver, Colorado

Names of institutions and type of transaction	*Total assets*
The Bank of Cherry Creek, National Association, Denver, Colorado (22332), with	---
and Cherry Creek National Bank, Denver, Colorado (14952), with	---
merged August 16, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

THE RIGGS NATIONAL BANK OF WASHINGTON,
Washington, D.C., and The National Bank of Washington, Washington, D.C.

Names of institutions and type of transaction	*Total assets*
The Riggs National Bank of Washington, Washington, D.C. (5046), with	$ 6,491,810,000
and The National Bank of Washington, Washington, D.C. (3425), with	---
merged August 10, 1990 under charter and title of the former. The merged bank at date of merger had	---

* * *

SOCIETY NATIONAL TRUST COMPANY,
Naples, Florida, and Trustcorp of Florida, National Association, Naples, Florida

Names of institutions and type of transaction	*Total assets*
Society National Trust Company, Naples, Florida (21914), with	$1,958,000
and Trustcorp of Florida, National Association, Naples, Florida (18728), with	624,000
merged July 1, 1990 under charter and title of the former. The merged bank at date of merger had	2,582,000

* * *

FIRST FLORIDA BANK, NATIONAL ASSOCIATION,
Tampa, Florida, and First Florida Bank of Orange County, National Association, Orlando, Florida

Names of institutions and type of transaction	*Total assets*
First Florida Bank, National Association, Tampa, Florida (3497), with	$5,542,711,000
and First Florida Bank of Orange County, National Association, Orlando, Florida (21651), with	10,305,000
merged September 22, 1990 under charter and title of the former. The merged bank at date of merger had	5,551,116,000

* * *

TRUST COMPANY BANK OF COLUMBUS, NATIONAL ASSOCIATION,
Columbus, Georgia, and Trust Company Bank of Troup County, National Association, La Grange, Georgia

Names of institutions and type of transaction	*Total assets*
Trust Company Bank of Columbus, National Association, Columbus, Georgia (4691), with	$245,078,000
and Trust Company Bank of Troup County, National Association, La Grange, Georgia, with	64,910,000
merged August 1, 1990, under charter and title of the former. The merged bank at date of merger had	309,988,000

* * *

THE FARMERS NATIONAL BANK OF GENESEO,
Geneseo, Illinois and Woodhull State Bank, Woodhull, Illinois,

Names of institutions and type of transaction	Total assets
The Farmers National Bank of Geneseo, Geneseo, Illinois (2332), with	$131,818,000
and Woodhull State Bank, Woodhull, Illinois, with	9,621,000
merged August 20, 1990, under charter and title of the former. The merged bank at date of merger had	141,976,000

* * *

THE FIRST NATIONAL BANK OF PHILLIPSBURG,
Phillipsburg, Kansas, and Commercial State Bank, Long Island, Kansas

Names of institutions and type of transaction	Total assets
The First National Bank of Phillipsburg, Phillipsburg, Kansas (3601) with	$75,883,000
and Commercial State Bank, Long Island, Kansas, with	11,758,000
merged July 28, 1990, under charter and title of the former. The merged bank at date of merger had	86,511,000

* * *

COMPTROLLER'S DECISION

On January 29, 1990, application was made to the Office of the Comptroller of the Currency (OCC) for prior authorization for The First National Bank of Phillipsburg, Phillipsburg, Kansas (FNB), to purchase the assets and assume the liabilities of Commercial State Bank, Long Island, Kansas (CSB). This application was based on an agreement completed between the proponents on December 19, 1989.

As of December 31, 1989, CSB, an independent bank, had total deposits of $12 million and operated one office. On the same date, FNB had total deposits of $16 million and operated two offices. FNB is 87 percent owned and controlled by Golden Plains Bancshares, Inc., a one bank holding company.

The relevant geographic market for this proposal is the town of Long Island and surrounding area which includes the townships of Prairie View and Granite. This is the area where CSB operates and derives the bulk of its deposits. FNB does not compete in this market. Accordingly, the proposed purchase and assumption would merely replace one competitor in the relevant market with another and would not have any significant adverse effects on competition.

The Bank Merger Act requires the OCC to consider "... the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of CSB and FNB do not raise concerns that would cause the application to be disapproved. The future prospects of the proponents, individually and combined, are considered favorable and the resulting bank is expected to meet the convenience and needs of the community to be served.

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities revealed no evidence that CSB's or FNB's record of helping meet the credit needs of its community, including low- and moderate-income neighborhoods, is less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) and find that it will not lessen significantly competition in any relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

Ballard Gilmore
Acting Deputy Comptroller
Bank Organization and Structure

June 20, 1990

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

FIRST OF AMERICA BANK-MID MICHIGAN, NATIONAL ASSOCIATION,
Bay City, Michigan, and First of America Bank-West Branch, West Branch, Michigan

Names of institutions and type of transaction	*Total assets*
First of America Bank-Mid Michigan, National Association, Bay City, Michigan (14641), with	$488,648,000
and First of America Bank-West Branch, West Branch, Michigan, with	68,404,000
merged August 1, 1990, under charter and title of the former. The merged bank at date of merger had	558,618,000

• • •

NATIONAL BANK OF DETROIT,
Detroit, Michigan, and NBD Alpena Bank, Alpena, Michigan, and NBD Genesee Bank, Flint, Michigan, and NBD Saginaw, Saginaw, Michigan, and NBD Sandusky Bank, Sandusky, Michigan

Names of institutions and type of transaction	*Total assets*
National Bank of Detroit, Detroit, Michigan (13671), with	$17,131,746,000
and NBD Alpena Bank, Alpena, Michigan, with	124,728,000
and NBD Genesee Bank, Flint, Michigan, with	1,095,192,000
and NBD Saginaw, Saginaw, Michigan, with	181,793,000
and NBD Sandusky Bank, Sandusky, Michigan, with	106,853,000
merged August 31, 1990, under charter 13671 and title "NBD Bank, National Association." The merged bank at date of merger had	18,561,231,000

• • •

CITIZENS NATIONAL BANK OF MARYVILLE,
Maryville, Missouri, and Farmers Bank of Grant City/Sheridan, Grant City, Missouri

Names of institutions and type of transaction	*Total assets*
Citizens National Bank of Maryville, Maryville, Missouri (21815), with	$122,737,000
and Farmers Bank of Grant City/Sheridan, Grant City, Missouri, with	9,931,000
merged September 21, 1990 under charter and title of the former. The merged bank at date of merger had	132,296,000

• • •

COMPTROLLER'S DECISION

On December 5, 1989, application was made to the Office of the Comptroller of the Currency (OCC) for prior authorization to purchase the assets and assume the liabilities of The Farmers Bank of Grant City/ Sheridan, Grant City, Missouri (Farmers) by Citizens National Bank of Maryville, Maryville, Missouri (Citizens). This application was based on an agreement completed between the proponents on October 30, 1989.

As of September 30, 1989, Farmers had total deposits of $9 million and operated two offices. Farmers is owned and controlled by HRH Bancorp. Inc., a one bank holding company. On the same date, Citizens had total deposits of $109 million and operated six offices. Citizens is wholly owned and controlled by Dickinson Financial Corporation, which owns a total of five bank subsidiaries with approximately $350 million in consolidated assets.

Farmers operates and derives the bulk of its deposits from Worth County. Farmers and Citizens are the only institutions operating in the county, which is a rural area with a population of 2,616. In light of the population of the county (See Decision of the Comptroller of the Currency on the application to merge The National Bank and Trust Company of Norwich, Norwich, New York with National Bank of Oxford, Oxford, New York, dated April 3, 1983), the opportunity for national banks to branch throughout Missouri (See Decision of the Comptroller of the Currency on the application of First National Bank and Trust Company, Columbia, Missouri, to establish a branch, dated January 26, 1989), and the existence of other possible entrants, I find that the appropriate relevant geographic market includes all of Worth and Nodaway counties, plus the communities of Stanberry and Albany in northern Gentry County.

Of the nine banks and thrifts operating within this market, Citizens is the second largest financial institution with a 23 percent market share of total deposits. Farmers is next to the smallest financial institution with 2 percent of the market share. After consummation of the merger, Citizens will remain the second largest with a 25 percent market share. In addition, seven different banks have offices located in five different communities that are within 26 miles of Grant City.

note, however, that the Attorney General has advised that the merger would not have a significantly adverse effect on competition.

The Bank Merger Act requires this OCC to consider the financial and managerial resources and future prospects of the existing and proposed institutions and the convenience and needs of the community to be served. We find that the financial and managerial resources of Citizens and Farmers do not raise concerns that would cause the application to be disapproved. The future prospects of the proponents, individually and combined, are considered favorable and the resulting bank is expected to meet the convenience and needs of the community to be served.

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities revealed no evidence that either bank's record of helping meet the credit needs of its community, including low- and moderate-income neighborhoods, is less than satisfactory.

We have analyzed this proposal pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) and find that it will not lessen significantly competition in any relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

J. Michael Shepherd
Senior Deputy Comptroller for
Corporate and Economic Programs

August 16, 1990

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

FIRST INTERSTATE BANK OF KALISPELL, NATIONAL ASSOCIATION,
Kalispell, Montana, and First Interstate Bank of Glacier County, Cut Bank, Montana, and First Interstate Bank of Great Falls,Great Falls, Montana

Names of institutions and type of transaction	*Total assets*
First Interstate Bank of Kalispell, National Association, Kalispell, Montana (4803), with	$124,516,000
and First Interstate Bank of Glacier County, Cut Bank, Montana, with	49,849,000
and First Interstate Bank of Great Falls, Great Falls, Montana, with	107,160,000
merged July 2, 1990, under charter 4803 and title "First Interstate Bank of Montana, National Association."	
The merged bank at date of merger had	279,626,000

* * *

NEW YORK CAPITAL BANK, NATIONAL ASSOCIATION,
New York City, New York, and Capital National Bank, Bronx, New York

Names of institutions and type of transaction	*Total assets*
New York Capital Bank, National Association, New York City, New York (22295), with	---
and Capital National Bank, Bronx, New York (16479), with	$158,197,000
merged July 6, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

KEY BANK OF WESTERN NEW YORK, NATIONAL ASSOCIATION,
Buffalo, New York, and The Permanent Savings Bank, Niagara Falls, New York

Names of institutions and type of transaction	*Total assets*
Key Bank of Western New York, National Association, Buffalo, New York (4988), with	$1,258,747,000
and The Permanent Savings Bank, Niagara Falls, New York, with	351,060,000
merged July 13, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

THE MERCHANTS NATIONAL BANK & TRUST COMPANY OF SYRACUSE, Syracuse, New York, and The First National Bank of Moravia, Moravia, New York

Names of institutions and type of transaction	*Total assets*
The Merchants National Bank & Trust Company of Syracuse, Syracuse, New York (1342), with	$676,353,000
and The First National Bank of Moravia, Moravia, New York (99), with	34,746,000
merged July 27, 1990, under charter and title of the former. The merged bank at date of merger had	711,099,000

* * *

FIRST NATIONAL BANK & TRUST COMPANY OF WILLISTON, Williston, North Dakota, and First National Bank of Crosby, Crosby, North Dakota

Names of institutions and type of transaction	*Total assets*
First National Bank & Trust Company of Williston, Williston, North Dakota (14275), with	$106,354,000
and First National Bank of Crosby, Crosby, North Dakota (16661), with	13,063,000
merged September 13, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

MCCLAIN COUNTY NATIONAL BANK, Purcell, Oklahoma, and First National Bank, Purcell, Oklahoma

Names of institutions and type of transaction	*Total assets*
McClain County National Bank, Purcell, Oklahoma (12134), with	$73,262,000
and First National Bank, Purcell, Oklahoma (18220), with	10,915,000
merged July 26, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

AMERICAN NATIONAL BANK, Ardmore, Oklahoma, and The Bank of Wilson, Wilson, Oklahoma

Names of institutions and type of transaction	*Total assets*
American National Bank, Ardmore, Oklahoma (17764), with	$43,302,000
and The Bank of Wilson, Wilson, Oklahoma, with	13,207,000
merged July 26, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST FIDELITY BANK, NATIONAL ASSOCIATION, Oklahoma City, Oklahoma, and Capitol Bank & Trust, Oklahoma City, Oklahoma

Names of institutions and type of transaction	*Total assets*
First Fidelity Bank, National Association, Oklahoma City, Oklahoma (17045), with	$57,923,000
and Capitol Bank & Trust, Oklahoma City, Oklahoma, with	33,095,000
merged August 16, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

WESTERN NATIONAL BANK, Odessa, Texas, and Bank of Odessa, Odessa, Texas

Names of institutions and type of transaction	*Total assets*
Western National Bank, Odessa, Texas (16658), with	$81,980,000
and Bank of Odessa, Odessa, Texas, with	14,364,000
merged July 26, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BANK ONE, TEXAS, NATIONAL ASSOCIATION,
Dallas, Texas, and United Bank of Waco, National Association, Waco, Texas

Names of institutions and type of transaction	Total assets
Bank One, Texas, National Association, Dallas, Texas (21969), with	$13,916,154,000
and United Bank of Waco, National Association, Waco, Texas (14901), with	262,460,000
merged August 2, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

TEXAS COMMERCE BANK-DALLAS, NATIONAL ASSOCIATION,
Dallas, Texas, and Chemical Bank Texas, National Association, Richardson, Texas

Names of institutions and type of transaction	Total assets
Texas Commerce Bank-Dallas, National Association, Dallas, Texas (15328), with	$2,086,958,000
and Chemical Bank Texas, National Association, Richardson, Texas (18639), with	46,945,000
merged August 6, 1990, under charter and title of the former. The merged bank at date of merger had	2,093,761,000

* * *

TEXAS COMMERCE BANK, NATIONAL ASSOCIATION,
Houston, Texas, and Texas Commerce Bank-Conroe, National Association, Conroe, Texas, and Texas Commerce Bank-Friendswood, Friendswood, Texas, and Texas Commerce Bank-Sugarland, National Association, Sugarland, Texas

Names of institutions and type of transaction	Total assets
Texas Commerce Bank, National Association, Houston, Texas (10225), with	$11,614,391,000
and Texas Commerce Bank-Conroe, National Association, Conroe, Texas (16521), with	126,171,000
and Texas Commerce Bank-Friendswood, Friendswood, Texas, with	141,084,000
and Texas Commerce Bank-Sugarland, National Association, Sugarland, Texas (17995), with	90,972,000
merged August 13, 1990, under charter and title of the former. The merged bank at date of merger had	11,658,487,000

* * *

CHARTER NATIONAL BANK-COLONIAL,
Houston, Texas, and City National Bank, Houston, Texas

Names of institutions and type of transaction	Total assets
Charter National Bank-Colonial, Houston, Texas (16493), with	$168,475,000
and City National Bank, Houston, Texas (20931), with	46,712,000
merged August 16, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

DEL RIO NATIONAL BANK,
Del Rio, Texas, and American Bank of Commerce, National Association, Del Rio, Texas

Names of institutions and type of transaction	Total assets
Del Rio National Bank, Del Rio, Texas (7433), with	$79,147,000
and American Bank of Commerce, National Association, Del Rio, Texas (16997), with	17,382,000
merged August 30, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

LIBERTY NATIONAL BANK,
Austin, Texas, and Security National Bank, National Association, Austin, Texas

Names of institutions and type of transaction	Total assets
Liberty National Bank, Austin, Texas (18647), with	$ 18,092,000
and Security National Bank, National Association, Austin, Texas (17588), with	15,849,000
merged August 30, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BANK ONE, TEXAS, NATIONAL ASSOCIATION,
Dallas, Texas, and Northside Bank, San Antonio, Texas

Names of institutions and type of transaction	Total assets
Bank One, Texas, National Association, Dallas, Texas (21969), with	$13,916,154,000
and Northside Bank, San Antonio, Texas, with	57,422,000
merged September 6, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST FREEPORT NATIONAL BANK,
Freeport, Texas, and Alvin National Bank, Alvin, Texas, and Coastal National Bank, Angleton, Texas, and Chemical National Bank, Clute, Texas

Names of institutions and type of transaction	Total assets
First Freeport National Bank, Freeport, Texas (10420), with	$63,189,000
and Alvin National Bank, Alvin, Texas (16887), with	18,425,000
and Coastal National Bank, Angleton, Texas (17615), with	26,574,000
and Chemical National Bank, Clute, Texas (16598), with	30,787,000
merged September 24, 1990, under charter 10420 and title "Texas Gulf Bank, National Association." The merged bank at date of merger had	139,976,000

* * *

TEXAS COMMERCE BANK-MIDLAND, NATIONAL ASSOCIATION,
Midland, Texas, and United Bank, National Association, Midland, Texas

Names of institutions and type of transaction	Total assets
Texas Commerce Bank-Midland, National Association, Midland, Texas (18304), with	$129,895,000
and United Bank, National Association, Midland, Texas (17874), with	187,807,000
merged September 24, 1990, under charter and title of the former. The merged bank at date of merger had	303,453,000

* * *

FIRST WESTERN NATIONAL BANK,
Carrollton, Texas, and Great Western National Bank, Lewisville, Texas

Names of institutions and type of transaction	Total assets
First Western National Bank, Carrollton, Texas (17516), with	$117,676,000
and Great Western National Bank, Lewisville, Texas (21189), with	13,700,000
merged September 27, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BELLINGHAM NATIONAL BANK,
Bellingham, Washington, and Valley Bank, Mount Vernon, Washington

Names of institutions and type of transaction	Total assets
Bellingham National Bank, Bellingham, Washington (21735), with	$264,780,000
and Valley Bank, Mount Vernon, Washington, with	43,934,000
merged August 1, 1990, under charter and title of the former. The merged bank at date of merger had	305,061,000

* * *

OLD NATIONAL BANK,
Martinsburg, West Virginia, and Morgan County State Bank, Inc., Berkeley Springs, West Virginia

Names of institutions and type of transaction	Total assets
Old National Bank, Martinsburg, West Virginia (6283), with	$156,757,000
and Morgan County State Bank, Inc., Berkeley Springs, West Virginia, with	15,637,000
merged July 2, 1990, under charter and title of the former. The merged bank at date of merger had	172,385,000

* * *

CHARLESTON NATIONAL BANK,
Charleston, West Virginia, and The Farmers and Citizens State Bank, Clendenin, West Virginia

Names of institutions and type of transaction	Total assets
Charleston National Bank, Charleston, West Virginia (3236), with	$419,772,000
and The Farmers and Citizens State Bank, Clendenin, West Virginia, with	44,691,000
merged August 1, 1990, under charter and title of the former. The merged bank at date of merger had	462,556,000

* * *

UNITED NATIONAL BANK-NORTH,
Wheeling, West Virginia, and First National Bank of Weirton, Weirton, West Virginia

Names of institutions and type of transaction	Total assets
United National Bank-North, Wheeling, West Virginia (14142), with	$131,331,000
and First National Bank of Weirton, Weirton, West Virginia (15414), with	42,829,000
merged August 31, 1990, under charter and title of the former. The merged bank at date of merger had	174,160,000

* * *

THE NATIONAL BANK OF COMMERCE OF CHARLESTON,
Charleston, West Virginia, and The National Bank of Commerce of Belle, Belle, West Virginia

Names of institutions and type of transaction	Total assets
The National Bank of Commerce of Charleston, Charleston, West Virginia (13509), with	$273,900,000
and The National Bank of Commerce of Belle, Belle, West Virginia (15385), with	46,857,000
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	320,721,000

* * *

M & I FIRST AMERICAN NATIONAL BANK,
Wausau, Wisconsin, and M & I Central National Bank, Wausau, Wisconsin

Names of institutions and type of transaction	Total assets
M & I First American National Bank, Wausau, Wisconsin (15424), with	$279,329,000
and M & I Central National Bank, Wausau, Wisconsin (15624), with	29,387,000
merged July 23, 1990, under charter and title of the former. The merged bank at date of merger had	308,593,000

* * *

TRI CITY NATIONAL BANK OF OAK CREEK,
Oak Creek, Wisconsin, and Tri City National Bank of West Allis, West Allis, Wisconsin, and Tri City National Bank of Menomonee Falls, Menomonee Falls, Wisconsin, and Tri City National Bank of Brookfield, Brookfield, Wisconsin, and Tri City National Bank of Brown Deer, Brown Deer, Wisconsin, and Tri City National Bank of Hales Corners, Hales Corners, Wisconsin

Names of institutions and type of transaction	Total assets
Tri City National Bank of Oak Creek, Oak Creek, Wisconsin (15738), with	$70,355,000
and Tri City National Bank of West Allis, West Allis, Wisconsin (16353), with	55,337,000
and Tri City National Bank of Menomonee Falls, Menomonee Falls, Wisconsin (21505), with	9,619,000
and Tri City National Bank of Brookfield, Brookfield, Wisconsin (20841), with	17,415,000
and Tri City National Bank of Brown Deer, Brown Deer, Wisconsin (16748), with	31,452,000
Tri City National Bank of Hales Corners, Hales Corners, Wisconsin (15785), with	53,302,000
merged August 13, 1990, under charter 15738 and title "Tri City National Bank."	
The merged bank at date of merger had	247,130,000

* * *

BANK ONE, APPLETON, NATIONAL ASSOCIATION,
Appleton, Wisconsin, and Bank One, Neenah, National Association, Neenah, Wisconsin

Names of institutions and type of transaction	Total assets
Bank One, Appleton, National Association, Appleton, Wisconsin (15580), with	$291,496,000
and Bank One, Neenah, National Association, Neenah, Wisconsin (6034), with	91,721,000
merged August 18, 1990, under charter and title of the former. The merged bank at date of merger had	383,217,000

* * *

STATE NATIONAL BANK OF PLATTEVILLE,
Platteville, Wisconsin, and Citizens State Bank, Montfort, Wisconsin, and Farmers and Merchants Bank, Shullsburg, Wisconsin, and The Bloomington State Bank, Bloomington, Wisconsin, and The First National Bank of Boscobel, Boscobel, Wisconsin

Names of institutions and type of transaction	Total assets
State National Bank of Platteville, Platteville, Wisconsin (15649), with	$45,876,000
and Citizens State Bank, Montfort, Wisconsin, with	14,485,000
and Farmers and Merchants Bank, Shullsburg, Wisconsin, with	18,111,000
and The Bloomington State Bank, Bloomington, Wisconsin, with	8,102,000
and The First National Bank of Boscobel, Boscobel, Wisconsin (16638), with	9,794,000
merged September 30, 1990, under charter 15649 and title "Clare Bank, National Association." The merged bank at date of merger had	95,867,000

WORTHEN BANK & TRUST COMPANY, NATIONAL ASSOCIATION,
Little Rock, Arkansas, and Independence Federal Bank, F.S.B., Batesville, Arkansas

Names of institutions and type of transaction	Total assets
Worthen Bank & Trust Company, National Association, Little Rock, Arkansas (16009), with	$571,618,000
and Independence Federal Bank, F.S.B., Batesville, Arkansas, with	171,734,000
merged September 7, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

SECURITY PACIFIC NATIONAL BANK,
Los Angeles, California, and Mercury Federal Savings and Loan Association, Huntington Beach, California

Names of institutions and type of transaction	Total assets
Security Pacific National Bank, Los Angeles, California (2491), with	$51,261,000,000
and Mercury Federal Savings and Loan Association, Huntington Beach, California, with	---
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

REPUBLIC NATIONAL BANK OF MIAMI,
Miami, Florida, and Miami Savings Bank, Miami, Florida

Names of institutions and type of transaction	Total assets
Republic National Bank of Miami, Miami, Florida (15555), with	$1,122,727,000
and Miami Savings Bank, Miami, Florida, with	---
merged August 17, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BARNETT BANK OF ALACHUA COUNTY, NATIONAL ASSOCIATION,
Gainesville, Florida, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Barnett Bank of Alachua County, National Association, Gainesville, Florida (16589), with	$314,135,000
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date merger had	---

* * *

BARNETT BANK OF CENTRAL FLORIDA, NATIONAL ASSOCIATION,
Orlando, Florida, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Barnett Bank of Central Florida, National Association, Orlando, Florida (14767), with	$2,666,652,000
and Empire Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BARNETT BANK OF LAKE COUNTY, NATIONAL ASSOCIATION, Mount Dora, Florida, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Barnett Bank of Lake County, National Association, Mount Dora, Florida (14783), with	---
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BARNETT BANK OF TAMPA, NATIONAL ASSOCIATION, Tampa, Florida, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Barnett Bank of Tampa, National Association, Tampa, Florida (16437), with	$1,487,735,000
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

TRUST COMPANY BANK OF SOUTH GEORGIA, NATIONAL ASSOCIATION, Albany, Georgia, and Albany First Federal Savings and Loan Association, Albany, Georgia

Names of institutions and type of transaction	Total assets
Trust Company Bank of South Georgia, National Association, Albany, Georgia (14907), with	$204,736,000
and Albany First Federal Savings and Loan Association, Albany, Georgia, with	183,762,000
merged September 1, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

COMPTROLLER'S DECISION

On February 2, 1990, application was made to the Office of the Comptroller of the Currency (OCC) for prior authorization to merge Albany First Federal Savings and Loan Association, Albany, Georgia (Albany First) with and into Trust Company Bank of South Georgia, National Association, Albany, Georgia (Trust Company Bank). Prior to the merger, Albany First will first be converted to a federally chartered stock association, then to a state chartered stock association. This application was based on an agreement completed between the proponents on November 27, 1989.

As of December 31, 1989, Albany First, an independent, federally chartered mutual savings and loan association, had total deposits of $171 million and operated eight branch offices. On the same date, Trust Company Bank had total deposits of $183 million and operated nine branch offices. Trust Company Bank is wholly owned and controlled by Trust Company of Georgia which is wholly owned by SunTrust Banks, Inc., Atlanta, Georgia. SunTrust Banks, Inc. owns a total of 53 banking subsidiaries throughout the southeastern United States with total consolidated assets of approximately $29 billion.

Albany First operates offices and derives the bulk of its deposits from Ben Hill, Dougherty, Irwin, Lee, Terrell, and Tift counties and the southern portion of Worth County. Trust Company Bank does not compete in Ben Hill, Irwin, Terrell, and Tift counties. Consequently, no adverse competitive effects will occur in those areas since the transaction will merely result in the replacement of one competitor with another.

The relevant geographic market for this proposal is considered to be Dougherty and Lee counties and the southern portion of Worth County, the area where both institutions compete. This market is currently served by five banks and three thrifts. The OCC considered the influence of the thrifts in its analysis, since the dominant thrift in the area offers commercial loans and a full range of consumer services. Albany First is the third largest depository in the market with 18 percent of the deposits, and Trust Company Bank is the fourth largest with 16 percent of the deposits. After consummation of the proposed merger, Trust Company Bank would become the largest depository in the relevant market with a 34 percent market share. While the proposed merger would eliminate some existing competition in the relevant market, any adverse effects would be mitigated by the presence of a number of other banking alternatives, including one of the largest financial institutions in the state.

The weak financial condition of Albany First further mitigates any possible anticompetitive effects of the proposal. Albany First has experienced severe financial problems in recent years, which have reduced its effectiveness as a competitor in the market. Albany First currently has no tangible capital and its continued

viability is unlikely. While the proposed merger will eliminate one competitor in the relevant market, it will also ensure continued service to those other areas currently served by Albany First. As a result of our analysis of the relevant market, the OCC believes that consummation of this proposal will not have a significantly adverse effect on competition.

The Bank Merger Act requires the OCC to consider ". . . the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." Despite the severe financial condition and technical insolvency of Albany First, we find that the financial and managerial resources of Trust Company Bank do not raise concerns that would cause the application to be disapproved. The future prospects of the combined entity are considered favorable and the resulting bank is expected to meet the convenience and needs of the community to be served.

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities revealed no evidence that Trust Company Bank's record of helping meet the credit needs of its community, including low- and moderate-income neighborhoods is less than satisfactory. It was noted that Albany First had a less than satisfactory record of performance under the CRA. The application reflects plans by Trust Company Bank to expand its community delineation to include those markets served by Albany First, and to serve those markets consistent with current Trust Company Bank policies.

We have analyzed this proposal pursuant to the Bank Merger Act (12 U.S.C. 1828(c)) and find that it will not lessen significantly competition in any relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved, subject to conditions disclosed in a separate communication to Trust Company Bank.

August 9, 1990

SUMMARY OF REPORT BY ATTORNEY GENERAL

We have reviewed this proposed transaction and conclude that it would not have a significantly adverse effect on competition.

* * *

FIRST MIDWEST BANK/DANVILLE, NATIONAL ASSOCIATION, Danville, Illinois, and Fidelity Savings Bank, F.S.B., Danville, Illinois

Names of institutions and type of transaction	*Total assets*
First Midwest Bank/Danville, National Association, Danville, Illinois (2584) with	$161,188,000
and Fidelity Savings Bank, F.S.B., Danville, Illinois, with	---
merged August 17, 1990, under charter and title of the former. The merged bank at date of merger had	---

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* * *

WATSEKA FIRST NATIONAL BANK, Watseka, Illinois, and Crest Federal Savings and Loan Association, Kankakee, Illinois

Names of institutions and type of transaction	*Total assets*
Watseka First National Bank, Watseka, Illinois (15022), with	$42,262,000
and Crest Federal Savings and Loan Association, Kankakee, Illinois, with	---
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

THE FIRST NATIONAL BANK OF CHICAGO, Chicago, Illinois, and Great American Federal Savings & Loan Association, Oak Park, Illinois

Names of institutions and type of transaction	*Total assets*
The First National Bank of Chicago, Chicago, Illinois (8), with	$37,860,975,000
and Great American Federal Savings & Loan Association, Oak Park, Illinois, with	1,013,231,000
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

NATIONAL BANK & TRUST COMPANY OF CHARITON,
Chariton, Iowa, and First Central Federal Savings Bank, Chariton, Iowa

Names of institutions and type of transaction	Total assets
National Bank & Trust Company of Chariton, Chariton, Iowa (13458), with	$55,291,000
and First Central Federal Savings Bank, Chariton, Iowa, with	---
merged September 7, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST COLONIAL BANK, NATIONAL ASSOCIATION,
Prairie Village, Kansas, and Colonial Federal Savings Association, Prairie Village, Kansas

Names of institutions and type of transaction	Total assets
First Colonial Bank, National Association, Prairie Village, Kansas (22331), with	---
and Colonial Federal Savings Association, Prairie Village, Kansas	---
merged August 10, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST NATIONAL BANK OF COMMERCE,
New Orleans, Louisiana, and French Market Homestead, Federal Savings Banc, Metairie, Louisiana

Names of institutions and type of transaction	Total assets
First National Bank of Commerce, New Orleans, Louisiana (13689), with	$2,831,559,000
and French Market Homestead, Federal Savings Banc, Metairie, Louisiana, with	---
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

COMMUNITY FIRST NATIONAL BANK OF WINDOM,
Windom, Minnesota, and United Savings Bank, F.S.B., Windom, Minnesota

Names of institutions and type of transaction	Total assets
Community First National Bank of Windom, Windom, Minnesota (5063), with	$33,417,000
and United Savings Bank, F.S.B., Windom, Minnesota, with	169,343,000
merged July 6, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST FARMERS & MERCHANTS NATIONAL BANK,
Fairmont, Minnesota, and Fairmont Federal Savings Association, Fairmont, Minnesota

Names of institutions and type of transaction	Total assets
First Farmers & Merchants National Bank, Fairmont, Minnesota (22351), with	---
and Fairmont Federal Savings Association, Fairmont, Minnesota, with	---
merged September 7, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

MERCANTILE BANK OF ST. LOUIS, NATIONAL ASSOCIATION,
Clayton, Missouri, and Missouri Savings Association, F.A., Clayton, Missouri

Names of institutions and type of transaction	Total assets
Mercantile Bank of St. Louis, National Association, Clayton, Missouri (21684), with	$4,153,471,000
and Missouri Savings Association, F.A., Clayton, Missouri, with	---
merged September 7, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST FIDELITY BANK, NATIONAL ASSOCIATION,
Burlington, New Jersey, and City Savings Bank, F.S.B., Elizabeth, New Jersey

Names of institutions and type of transaction	Total assets
First Fidelity Bank, National Association, Burlington, New Jersey (1222), with	$2,241,671,000
and City Savings Bank, F.S.B., Elizabeth, New Jersey, with	8,582,471,000
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

KEY BANK OF WESTERN NEW YORK, NATIONAL ASSOCIATION,
Buffalo New York, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Key Bank of Western New York, National Association, Buffalo, New York (4988), with	$1,258,747,000
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

KEY BANK OF CENTRAL NEW YORK, NATIONAL ASSOCIATION,
Syracuse, New York, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Key Bank of Central New York, National Association, Syracuse, New York (18756), with	---
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

KEY BANK OF EASTERN NEW YORK, NATIONAL ASSOCIATION,
Albany, New York, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Key Bank of Eastern New York, National Association, Albany, New York (1301), with	$3,645,628,000
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BISMARK NATIONAL BANK,
Bismark, North Dakota, and Midwest Federal Savings Bank of Minot, Minot, North Dakota

Names of institutions and type of transaction	Total assets
Bismark National Bank, Bismark, North Dakota (22352), with	---
and Midwest Federal Savings Bank of Minot, Minot, North Dakota, with	---
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

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THE RAMSEY NATIONAL BANK AND TRUST COMPANY OF DEVILS LAKE,
Devils Lake, North Dakota, and Midwest Federal Savings Bank of Minot, Minot, North Dakota

Names of institutions and type of transaction	Total assets
The Ramsey National Bank and Trust Company of Devils Lake, Devils Lake, North Dakota (5886), with	$67,690,000
and Midwest Federal Savings Bank of Minot, Minot, North Dakota, with	---
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

COMMUNITY FIRST NATIONAL BANK AND TRUST COMPANY OF DICKINSON,
Dickinson, North Dakota, and Midwest Federal Savings Bank of Minot, Minot, North Dakota

Names of institutions and type of transaction	Total assets
Community First National Bank and Trust Company of Dickinson, Dickinson, North Dakota (4384), with	$55,519,000
and Midwest Federal Savings Bank of Minot, Minot, North Dakota, with	---
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

THE FIRST NATIONAL BANK OF FESSENDEN,
Fessenden, North Dakota, and Midwest Federal Savings Bank of Minot, Minot, North Dakota

Names of institutions and type of transaction	Total assets
The First National Bank of Fessenden, Fessenden, North Dakota (5408), with	$28,584,000
and Midwest Federal Savings Bank of Minot, Minot, North Dakota, with	---
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

THE FIRST NATIONAL BANK AND TRUST COMPANY OF HOLDENVILLE,
Holdenville, Oklahoma, and First Federal Savings & Loan Association of Seminole, Seminole, Oklahoma

Names of institutions and type of transaction	Total assets
The First National Bank and Trust Company of Holdenville, Holdenville, Oklahoma (5270), with	$74,109,000
and First Federal Savings & Loan Association of Seminole, Seminole, Oklahoma, with	29,759,000
merged September 21, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BANK ONE, TEXAS, NATIONAL ASSOCIATION,
Dallas, Texas, and Capital City F.S.A., Austin, Texas

Names of institutions and type of transaction	Total assets
Bank One, Texas, National Association, Dallas, Texas (21969), with	$13,916,154,000
and Capital City F.S.A., Austin, Texas, with	408,569,000
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

PLAZA BANK, NATIONAL ASSOCIATION,
San Antonio, Texas, and Suburban Savings Association, San Antonio, Texas

Names of institutions and type of transaction	Total assets
Plaza Bank, National Association, San Antonio, Texas (16578), with	$16,443,000
and Suburban Savings Association, San Antonio, Texas, with	36,507,000
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

BANK ONE, TEXAS, NATIONAL ASSOCIATION,
Dallas, Texas, and Empire Federal Savings Bank of America, Buffalo, New York

Names of institutions and type of transaction	Total assets
Bank One, Texas, National Association, Dallas, Texas (21969), with	$13,916,154,000
and Empire Federal Savings Bank of America, Buffalo, New York, with	---
merged September 28, 1990, under charter and title of the former. The merged bank at date of merger had	---

* * *

FIRST SECURITY BANK OF UTAH, NATIONAL ASSOCIATION,
Ogden, Utah, and Williamsburg Federal Savings and Loan Association, Salt Lake City, Utah

Names of institutions and type of transaction	Total assets
First Security Bank of Utah, National Association, Ogden, Utah (2597), with	$3,576,602,000
and Williamsburg Federal Savings and Loan Association, Salt Lake City, Utah, with	---
merged September 14, 1990, under charter and title of the former. The merged bank at date of merger had	---

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Statistical Tables

Tables produced by the Industry and Financial Analysis Division

Assets, liabilities and capital accounts of national banks, September 30, 1989, and September 30, 1990
(Dollar amounts in millions)

	Sept 30 1989	*Sept 30 1990*	[illegible]	
	Consolidated foreign and domestic	*Consolidated foreign and domestic*	[illegible]	[illegible]
Assets				
Cash and balances due from depository institutions				
Noninterest-bearing balances and currency and coin	$ 121,439	$ 118,093	[illegible]	[illegible]
Interest-bearing balances	72,829	57,706	[illegible]	[illegible]
Securities	291,166	314,849	[illegible]	8.1
Federal funds sold and securities purchased under agreements to resell	77,013	86,76[illegible]	9,748	[illegible]
Loans and leases, net of unearned income	1,246,572	1,277,697	[illegible]	[illegible]
Less allowance for loan and lease losses	30,666	31,911	[illegible]	[illegible]
Less allocated transfer risk reserve	162	169	[illegible]	[illegible]
Net loans and leases	1,215,744	1,245,618	[illegible]	[illegible]
Premises and fixed assets	27,725	29,466	1,741	6.3
Other real estate owned	7,988	12,622	4,634	58.0
Other assets	107,215	113,967	[illegible]	6.3
Total assets	1,921,119	1,979,083	57,964	[illegible]
Liabilities				
Deposits				
Noninterest-bearing deposits in domestic offices	258,430	259,774	1,344	0.5
Interest-bearing deposits in domestic offices	989,263	1,061,017	71,754	7.3
Total domestic deposits	1,247,693	1,320,791	73,098	5.9
Total foreign deposits	196,145	204,597	8,453	4.3
Total deposits	1,443,838	1,525,389	[illegible]	5.6
Federal funds purchased and securities sold under agreements to repurchase	183,059	160,554	22,505	12.3
Demand notes issued to the U.S. Treasury	18,363	22,992	4,630	25.2
Other borrowed money	78,750	69,519	[illegible]	[illegible]
Subordinated notes and debentures	10,986	10,854	[illegible]	[illegible]
All other liabilities	71,882	69,859	[illegible]	–2.8
Total liabilities	1,806,879	1,859,166	[illegible]	2.9
Limited-life preferred stock	79	77	[illegible]	2.5
Equity capital				
Perpetual preferred stock	813	465	348	42.8
Common stock	16,448	16,556	108	0.7
Surplus	40,998	46,366	5,368	13.1
Net undivided profits and capital reserves	56,282	56,800	[illegible]	0.9
Cumulative foreign currency translation agreements	–388	–356	[illegible]	[illegible]
Total equity capital	114,153	119,832	5,679	[illegible]
Total liabilities, limited-life preferred stock, and equity capital	1,921,119	1,979,083	57,964	[illegible]

Income and expenses of foreign and domestic offices and subsidiaries of national banks, September 30, 1990
(Dollar amounts in millions)

	4,006 banks*	
	Consolidated foreign and domestic	*Percent distribution*
Interest income		
Interest and fee income on loans	$108,466	75.1
Income from lease financing receivables	2,593	1.8
Interest income on balances due from depository institutions	5,460	3.8
Interest and dividend income on securities	20,258	14.0
Interest income from assets held in trading accounts	2,093	1.4
Interest income from federal funds sold and securities purchased under agreements to resell	5,549	3.8
Total interest income	144,399	100.0
Interest expense		
Interest on deposits	71,690	76.1
Expense of federal funds purchased and securities sold under agreements to repurchase	11,248	11.9
Interest on demand notes issued to the U.S. Treasury and on other borrowed money	10,370	11.0
Interest on mortgage indebtedness and obligations under capitalized leases	123	0.1
Interest on notes and debentures subordinated to deposits	774	0.8
Total interest expense	94,206	100.0
Net interest income	50,193	
Provision for loan and lease losses	13,512	
Provision for allocated transfer risk	–37	
Noninterest income		
Service charges on deposit accounts	5,298	20.9
Other noninterest income	20,100	79.1
Total noninterest income	25,398	100.0
Gains and losses on securities not held in trading accounts	135	
Noninterest expense		
Salaries and employee benefits	22,656	44.1
Expenses of premises and fixed assets (net of rental income)	7,780	15.1
Other noninterest expense	20,935	40.8
Total noninterest expense	51,372	100.0
Income (loss) before income taxes and extraordinary items and other adjustments	10,880	
Applicable income taxes	3,563	
Income before extraordinary items and other adjustments	7,317	
Extraordinary items and other adjustments, net of taxes	125	
Net income	7,442	
Total cash dividends declared*	5,390	
Recoveries credited to allowance for possible loan losses	2,069	
Losses charged to allowance for possible loan losses	15,655	
Net loan losses	13,585	

*Banks with assets of less than $100 million report this item only in their December Report of Income

Loans of national banks, by states, September 30, 1990
(Dollar amounts in millions)

	Total loans, gross	Domestic offices					Total loans at foreign offices
		Loans secured by real estate	Loans to farmers	Commercial and industrial loans	Personal loans to individuals	Other loans	
All national banks	$1,285,991	$474,016	$14,729	$318,917	$110,237	$223,115	$144 976
Alabama	10,570	4,216	56	3,296	732	2 270	0
Alaska	1,431	554	1	554	40	275	7
Arizona	11,003	3,495	419	2,265	2,400	2,425	0
Arkansas	5,598	2,640	262	1,230	1,114	352	0
California	181,289	81,957	2,103	31,817	2,932	30,512	31 968
Colorado	11,181	4,383	469	2,537	2,712	1,078	1
Connecticut	12,474	7,335	24	3,305	120	1,691	0
Delaware	10,534	515	1	133	7,991	1,895	0
District of Columbia	11,273	5,241	0	3,004	72	2,113	843
Florida	65,805	36,384	206	11,261	6,642	11,205	106
Georgia	26,407	9,819	83	7,069	3,075	6,164	197
Hawaii	187	117	0	53	12	5	0
Idaho	4,676	1,203	531	1,223	1,354	366	0
Illinois	68,992	19,739	830	25,635	6,087	9,796	6 904
Indiana	21,406	8,282	316	5,454	3,970	3,384	0
Iowa	6,217	2,168	550	1,460	1,704	336	0
Kansas	6,581	2,538	728	1,605	1,396	314	0
Kentucky	10,196	3,464	130	2,973	1,320	2,305	4
Louisiana	13,106	5,380	99	3,457	1,308	2,515	347
Maine	2,737	1,755	15	529	352	86	0
Maryland	19,528	8,459	24	4,069	3,410	3,267	299
Massachusetts	41,259	13,619	32	15,487	448	7,309	4,363
Michigan	33,247	12,285	126	11,254	2,592	5,569	1,422
Minnesota	22,514	5,976	484	8,779	1,583	5,476	216
Mississippi	5,419	2,240	105	1,329	766	980	0
Missouri	17,678	7,973	331	4,502	1,916	2,956	0
Montana	1,945	607	237	478	574	48	0
Nebraska	6,290	1,587	1,041	1,262	1,981	420	0
Nevada	7,982	1,574	20	686	5,500	203	0
New Hampshire	1,606	832	0	521	224	29	0
New Jersey	47,023	23,428	18	13,047	3,073	7,277	180
New Mexico	3,713	1,912	123	750	813	115	0
New York	232,263	60,826	357	40,170	5,109	31,798	94 002
North Carolina	37,204	15,442	154	11,883	559	8,785	381
North Dakota	1,543	569	228	357	326	63	0
Ohio	57,007	18,982	338	16,220	6,777	14,624	66
Oklahoma	6,704	2,775	532	1,776	869	752	0
Oregon	12,137	3,537	268	4,362	85	3,885	0
Pennsylvania	71,418	23,226	108	23,888	5,457	16,559	2,181
Rhode Island	9,581	3,324	2	2,781	192	3,245	37
South Carolina	13,779	6,557	54	3,011	2,384	1 772	0
South Dakota	10,946	670	285	1,470	8,398	123	0
Tennessee	15,126	6,433	62	3,564	949	4,118	0
Texas	57,586	19,348	1,446	20,538	4,877	10,065	1,312
Utah	4,627	1,635	105	1,065	148	1,674	0
Vermont	1,822	1,136	24	404	218	39	0
Virginia	19,430	8,775	128	4,610	1,461	4,452	2
Washington	25,690	10,859	941	6,610	677	6,476	127
West Virginia	5,646	2,772	11	1,058	1,625	180	0
Wisconsin	12,733	5,197	219	3,888	1,671	1,748	10
Wyoming	830	261	103	226	220	19	0
Puerto Rico	48	15	0	12	20	1	0

*Zeros indicate amounts of less than $500,000

Deposits of national banks, by states, September 30, 1990
(Dollar amounts in millions)

	Domestic offices						
	Total* demand deposits	All NOW accounts	Money market deposit accounts	Large time deposits	All other deposits at domestic offices	Total* deposits at foreign offices	Total consolidated deposits
All national banks	$252,619	$115,121	$231,613	$223,770	$497,661	$204,597	$1,525,381
Alabama	2,161	1,171	2,716	1,727	5,487	187	13,449
Alaska	792	184	361	431	886	1	2,654
Arizona	2,682	1,484	2,697	1,546	6,644	0	15,053
Arkansas	1,445	1,313	1,008	1,263	4,206	0	9,235
California	34,533	13,794	31,939	26,305	46,639	28,961	182,171
Colorado	3,926	2,249	3,846	2,179	5,040	185	17,424
Connecticut	3,444	1,254	2,487	1,983	7,914	410	17,493
Delaware	278	76	1,319	1,846	1,910	10	5,439
District of Columbia	2,676	1,212	3,338	3,235	2,619	2,316	15,395
Florida	13,535	7,458	14,243	13,307	31,574	774	80,890
Georgia	6,483	2,463	5,715	3,764	9,862	480	28,767
Hawaii	54	33	23	54	92	0	256
Idaho	913	609	894	520	2,426	0	5,363
Illinois	14,167	5,268	9,006	18,482	24,506	20,399	91,827
Indiana	4,301	2,559	3,929	3,214	11,339	108	25,451
Iowa	1,612	1,113	1,119	576	4,684	0	9,104
Kansas	1,630	1,247	1,674	1,473	5,342	0	11,367
Kentucky	2,202	1,540	1,249	1,558	5,576	239	12,363
Louisiana	3,579	1,596	3,105	3,892	6,667	265	19,105
Maine	453	314	495	221	1,634	0	3,117
Maryland	3,842	1,258	2,916	4,177	8,572	759	21,524
Massachusetts	6,354	2,318	8,892	7,277	11,375	7,943	44,160
Michigan	7,824	2,465	6,945	6,863	17,221	2,344	43,663
Minnesota	5,082	2,610	4,366	4,838	9,156	748	26,800
Mississippi	1,314	873	1,077	1,227	3,817	0	8,307
Missouri	4,758	2,511	3,874	2,766	9,422	79	23,410
Montana	507	432	620	225	1,484	0	3,268
Nebraska	1,514	1,213	1,178	638	4,855	0	9,398
Nevada	1,111	493	1,175	1,226	1,156	0	5,162
New Hampshire	330	300	183	224	910	0	1,946
New Jersey	10,993	4,691	9,054	6,603	26,200	206	57,746
New Mexico	882	828	766	940	2,395	0	5,811
New York	29,809	7,872	28,745	26,928	37,421	126,013	256,788
North Carolina	5,957	2,078	5,130	8,828	12,237	2,508	36,739
North Dakota	324	406	357	224	1,489	0	2,800
Ohio	10,336	5,754	9,059	9,024	29,925	1,459	65,557
Oklahoma	2,551	1,577	1,584	1,676	5,436	78	12,901
Oregon	2,444	1,653	2,731	1,510	4,977	0	13,315
Pennsylvania	14,207	5,444	13,051	14,344	34,466	4,126	85,637
Rhode Island	1,021	456	1,292	3,465	3,491	846	10,571
South Carolina	2,350	1,874	3,014	1,573	5,062	0	13,873
South Dakota	456	434	1,140	1,918	2,489	0	6,437
Tennessee	3,466	1,816	3,967	2,091	8,629	74	20,042
Texas	19,486	10,529	17,376	17,612	34,025	2,584	101,612
Utah	1,056	671	942	455	2,454	90	5,667
Vermont	227	199	358	291	1,006	0	2,082
Virginia	3,520	2,302	2,198	3,760	9,916	47	21,743
Washington	5,905	2,658	5,421	2,700	9,947	335	26,965
West Virginia	1,075	895	690	701	5,172	0	8,533
Wisconsin	2,764	1,287	2,061	1,795	7,161	24	15,091
Wyoming	280	285	284	278	718	0	1,846
Puerto Rico	8	4	0	15	33	0	61

*Zeros indicate amounts of less than $500,000

Consolidated foreign and domestic loans and leases past due at national banks, by states, September 30 1990
(Dollar amounts in millions)

	Number of banks	Type of loan						
		All real estate	Commercial and industrial[1]	Personal[2]	Leases	Other [illegible][3]	[illegible]	[illegible]
All national banks	4 006	$13 097 00	$6 611 65	$8 619 87	$408 5[illegible]	[illegible]	[illegible]	[illegible]
Alabama	51	61 04	44 81	65 12	0 07	[illegible]	[illegible]	[illegible]
Alaska	4	20 59	10 85	1 89	0 00	[illegible]	[illegible]	[illegible]
Arizona	12	126 53	88 17	75 54	2 15	[illegible]	[illegible]	[illegible]
Arkansas	80	60 61	39 34	29 09	0 00	[illegible]	[illegible]	[illegible]
California	159	1 890 14	933 87	674 94	[illegible]	[illegible]	[illegible]	[illegible]
Colorado	259	93 03	95 78	65 73	1 00	[illegible]	[illegible]	[illegible]
Connecticut	18	356 25	130 02	52 05	0 00	[illegible]	[illegible]	[illegible]
Delaware	13	8 79	8 44	421 34	1 15	0 01	[illegible]	[illegible]
District of Columbia	24	204 93	174 30	31 48	0 24	[illegible]	[illegible]	[illegible]
Florida	167	970 07	224 90	328 57	8 19	25 55	1 557 29	[illegible]
Georgia	70	177 57	143 00	248 31	[illegible]	19 68	597 69	[illegible]
Hawaii	3	0 35	0 07	0 18	0 00	0 00	0 60	0 00
Idaho	7	12 14	9 35	22 72	0 29	2 60	47 10	0 00
Illinois	351	390 10	362 21	180 26	0 97	26 88	960 43	3 89
Indiana	88	180 62	82 30	172 35	6 23	4 72	446 23	0 00
Iowa	97	23 22	24 45	64 25	0 19	0 39	112 50	0 00
Kansas	162	39 45	39 30	24 02	0 66	0 07	103 50	0 00
Kentucky	83	63 56	81 35	56 50	3 07	3 08	207 56	0 00
Louisiana	48	139 22	99 34	91 97	0 61	4 15	335 28	0 00
Maine	7	61 70	13 97	12 23	0 00	0 00	87 90	0 00
Maryland	28	146 23	81 17	284 95	13 87	27 60	553 81	0 00
Massachusetts	35	672 47	261 85	113 93	27 61	56 73	1 132 58	25 82
Michigan	70	233 56	153 73	135 50	4 85	12 55	540 20	0 98
Minnesota	155	164 63	238 82	102 15	11 20	18 69	535 49	0 02
Mississippi	26	45 71	18 89	34 54	0 00	6 07	105 20	0 00
Missouri	91	145 93	104 84	67 72	0 43	3 15	322 07	0 00
Montana	43	11 23	12 48	12 65	0 17	10 27	46 80	0 00
Nebraska	111	18 60	32 02	57 38	0 47	0 98	109 45	0 00
Nevada	7	26 46	10 88	626 01	0 14	1 68	665 16	0 00
New Hampshire	10	53 35	27 52	13 15	0 00	0 12	94 14	0 00
New Jersey	55	1 138 41	412 80	247 10	17 40	47 90	1 863 60	0 00
New Mexico	41	49 39	40 82	21 74	0 82	0 11	112 88	0 00
New York	94	2 039 57	667 98	1 300 67	116 84	304 43	4 429 50	699 41
North Carolina	16	305 30	101 72	94 16	3 14	11 59	515 92	0 83
North Dakota	29	10 96	18 90	9 83	0 03	1 36	41 08	0 00
Ohio	133	486 50	179 75	558 87	24 07	20 47	1 269 66	0 00
Oklahoma	169	57 57	50 99	27 08	0 00	1 66	137 30	0 00
Oregon	7	47 11	16 40	36 38	13 14	4 90	117 94	0 00
Pennsylvania	161	584 90	381 55	297 33	47 54	97 19	1 408 51	10 10
Puerto Rico	1	0 00	6 99	0 91	0 00	0 00	7 90	0 00
Rhode Island	5	189 30	81 93	37 83	43 3[illegible]	7 83	360 20	0 00
South Carolina	31	123 75	51 63	93 85	1 99	4 23	275 46	0 00
South Dakota	21	7 52	128 11	1 046 57	0 08	1 81	1 184 09	0 00
Tennessee	47	154 38	68 04	117 63	4 94	6 63	351 62	0 00
Texas	610	559 68	394 07	282 76	3 73	76 75	1 316 99	[illegible]
Utah	6	58 51	15 41	27 68	0 93	3 39	105 92	0 00
Vermont	12	31 65	21 04	7 34	0 00	0 08	60 1[illegible]	[illegible]
Virginia	51	515 73	155 14	123 25	0 00	[illegible]	8[illegible] 30	[illegible]
Washington	28	46 40	98 94	111 90	1 90	[illegible] 43	380 58	[illegible]
West Virginia	79	69 93	45 03	58 83	0 00	0 00	173 80	[illegible]
Wisconsin	99	117 54	115 12	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Wyoming	32	4 82	11 25	5 10	0 00	0 00	[illegible]	[illegible]

[1]For banks with assets of less than $300 million this category captures commercial [illegible] and [illegible] other loans
[2]For banks with assets of less than $300 million this category captures installment [illegible] and credit [illegible]
[3]For banks with assets of less than $300 million all other loans are reported under commercial and industrial category

*Percent of total loans past due, by asset size of national banks**

	Less than $300M	$300M to $1B	$1B to $10B	Greater than $10B	All national banks
Real estate					
December 1989	2.36	2.24	2.57	2.89	2.65
March 1990	2.44	2.42	3.02	3.22	2.97
June 1990	2.11	2.11	2.30	2.71	2.45
September 1990	2.15	2.12	2.76	2.80	2.63
Commercial and industrial[2]					
December 1989	4.32	2.59	1.89	1.27	1.79
March 1990	5.15	3.14	2.35	1.29	2.02
June 1990	4.51	2.60	2.17	1.13	1.78
September 1990	4.36	2.72	1.96	1.09	1.70
Personal[3]					
December 1989	2.81	3.21	3.23	4.08	3.45
March 1990	2.52	2.96	3.83	3.09	3.36
June 1990	2.58	2.91	3.66	2.97	3.22
September 1990	2.70	3.21	4.27	3.26	3.63
Leases					
December 1989	2.06	1.76	2.43	0.94	1.49
March 1990	2.23	1.57	1.51	1.47	1.49
June 1990	2.14	1.37	1.43	1.14	1.24
September 1990	2.13	1.47	1.68	1.43	1.51
Other loans[3]					
December 1989	0.04	0.87	1.05	0.76	0.79
March 1990	0.03	1.25	1.56	1.08	1.14
June 1990	0.02	0.79	1.15	0.79	0.83
September 1990	0.03	0.77	1.07	1.01	0.93
Total loans					
December 1989	2.72	2.48	2.41	2.11	2.31
March 1990	2.88	2.64	2.90	2.16	2.52
June 1990	2.57	2.33	2.49	1.88	2.19
September 1990	2.57	2.43	2.75	1.98	2.33

*Past due loans in each category are stated as a percentage of loans outstanding of that type.
[2] For banks with assets of less than $300 million, this category captures commercial (time and demand) and all other loans.
[3] For banks with assets of less than $300 million, this category captures installment loans and credit cards and related plans.

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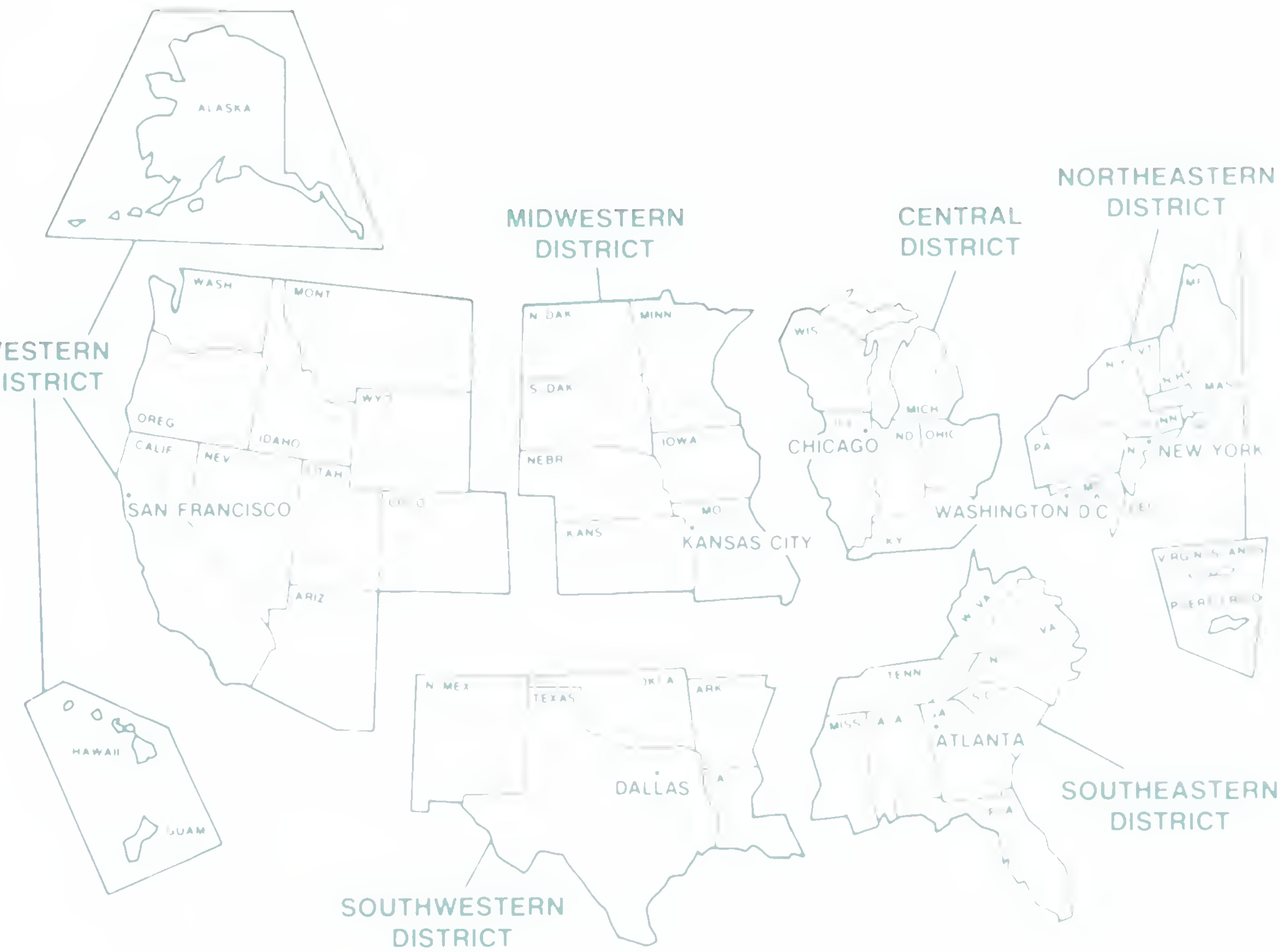

Northeastern District

New York District Office
1114 Avenue of the Americas
Suite 3900
New York, NY 10036

FTS [illegible]
Commercial [illegible]

Central District

Chicago District Office
[illegible]

FTS [illegible]
Commercial [illegible]

Southwestern District

Dallas District Office
[illegible]

Commercial [illegible]

Southeastern District

Atlanta District Office
[illegible]
Atlanta, GA 30303

Commercial 404-659-[illegible]

Midwestern District

Kansas City District Office
[illegible]

Commercial [illegible]

Western District

San Francisco District Office
[illegible]

FTS [illegible]
Commercial [illegible]

SPECIAL FOURTH-CLASS RATE
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Comptroller of the Currency
Administrator of National Banks

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